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STATUS OF THE U.S. FINANCIAL SYSTEM

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

LEGISLATION TO MODIFY THE CURRENT RESTRICTIONS ON FEDERALLY INSURED DEPOSITORY INSTITUTIONS AND THEIR HOLDING COMPANIES BY INCLUDING AUTHORITY TO UNDERWRITE COMMERCIAL PAPER, MORTGAGE-BACKED SECURITIES, MUNICIPAL REVENUE BONDS, AND TO SPONSOR MUTUAL FUNDS

JUNE 18, 1987

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STATUS OF THE U.S. FINANCIAL SYSTEM

THURSDAY, JUNE 18, 1987

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10 a.m., in room SD-538, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Riegle, Sarbanes, Dodd, Dixon, Sasser, Sanford, Shelby, Graham, Wirth, Garn, Armstrong, D'Amato, Hecht, Gramm, Bond, Chafee, and Karnes.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

The CHAIRMAN. The committee will come to order.

This morning we begin a series of critically important hearings on comprehensive restructuring of the financial services system. As I have said on numerous occasions, it's my firm intention to have this committee consider legislation to modify the current restrictions on federally insured depository institutions and their holding companies.

To assist in our deliberations we will hear from a wide variety of experts on the changes underway in the domestic and international financial markets and the implications of these changes for the framework of law and regulation that now govern U.S. depository institutions.

We begin with the testimony of three of our Nation's most noted experts on financial market change: Jerry Corrigan, President of the Federal Reserve Bank of New York; Walter Wriston, former chairman of Citicorp; and John Weinberg, senior partner of Goldman, Sachs.

Each of these gentlemen has been at the leading edge of financial evolution for a decade or more and in some respects have themselves been important motivators of change. I believe the testimony of these witnesses—and these hearings generally—could not be more urgent than they are right now. Years of richly documented studies on sweeping financial change have primed us for congressional action.

As everyone in this audience is aware, the Senate and the House are nearing final action on legislation that will set the stage for a fresh look at the choices before Congress.

My own priorities in our deliberations and actions should be clear. I remain committed to legislation that provides the banking industry with four new powers within a framework that assures the soundness of depository institutions and protects against the evils of market concentration.

The four new powers I have in mind include authority to underwrite commercial paper, mortgage-backed securities, municipal revenue bonds, and to sponsor mutual funds.

Commercial paper is the securities equivalent of a commercial loan. It is a proper and prudent province of banks.

Mortgage making has long been a banking practice and a natural extension of mortgage-backed securities and underwriting.

Municipal revenue bond underwriting, similarly, is a logical supplement to general obligation bond underwriting.

Mutual fund operations constitute an activity that can be safely handled through banks.

I have great respect for the reasoning that led an earlier Congress to enact a Glass-Steagall Act. The four activities I have outlined, however, in my judgment, can be engaged in by banking organizations without running the risks that the Glass-Steagall Act is intended to prevent.

Naturally other members of this committee and certainly other witnesses will highlight other issues and new powers. I look forward to an opportunity to hear those views and the committee's consideration of them, keeping in mind that our highest goal is the long-term improvement of the soundness and quality of financial services to businesses and consumers in the United States.

Senator Armstrong.

OPENING STATEMENT OF SENATOR ARMSTRONG

Senator ARMSTRONG. Mr. Chairman, thank you very much.

I compliment you. We've got a really high-powered bunch of witnesses today and I'm looking forward to their testimony, particularly because, as you have pointed out, each of them in one way or another has been responsible for some of the sweeping changes that have occurred in the industry and have advocated some additional changes.

I happen to believe that we are way, way past the moment when some kind of patch on the balloon will be a good proposal and so I am hopeful that out of this hearing and the ones to follow we can develop some kind of comprehensive approach at long last.

I can say to the witnesses that I am confident this will happen because this is my ninth year on this committee and I have been assured practically every day for the last 9 years that a broad-based reform is imminent, so I'm sure we're nearly there.

Thank you, Mr. Chairman. I'm looking forward to the task ahead.

The CHAIRMAN. Well, those remarks have a certain edge.

Senator ARMSTRONG. I didn't mean them to.

The CHAIRMAN. Well, the year has come and we're going to prove it to you.

Senator Shelby.

OPENING STATEMENT OF SENATOR SHELBY

Senator SHELBY. Thank you, Mr. Chairman.

Mr. Chairman, I want to commend you for your leadership in calling these hearings. In light of the breakdowns in barriers separating financial institutions that have occurred over the past 10 years, it's appropriate I believe for this committee to conduct a comprehensive reassessment of the Glass-Steagall Act.

The financial services industry has undergone a revolution since the legal framework of the 1930's was erected. I believe it's past the time to consider establishing a new framework that will meet the changing needs of the 21st century rather than remaining tied to the legacy of the 1930's legislation.

I believe we need to consider whether we should let the commercial banks into some fields from which they are currently prohibited from entering. Piecemeal, judicial, and administrative decisions such as the Federal Reserve Board's recent 3-to-2 vote on securities applications are allowing our financial institutions to evolve in a haphazard way. This is no way to make public policy.

If Dr. Greenspan's views, some of his writings and previous utterings prevail, the Fed will increasingly become involved in what I believe is a policymaking area that should be reserved for this Congress. I believe it's time for Congress to overcome its inertia and reassert its responsibility to establish a systematic public policy.

The hearings here today provide an important opportunity to consider whether to allow commercial banks to underwrite securities and manage mutual funds and what regulations should accompany an expansion of banks' powers to assure long-term financial soundness in this country. In the interest of fair competition, should the activities of commercial banks be expanded? Should the securities industry be afforded comparable opportunity to engage in commercial banking activities also? Removal of Glass-Steagall barriers to competition might improve the capital market efficiency in the United States.

A small number of national investment banking firms control the highly profitable underwriting and the large bloc transactions of dealing markets for major corporations here. Commercial banks are prohibited from participating in those markets, despite significant concentration, high securities profits, and limited availability of some services to smaller business enterprises.

I look forward to this distinguished panel's testimony here today and the questions that will come later.

The CHAIRMAN. Senator Garn.

Senator GARN. Thank you, Mr. Chairman. I will be very brief because I think most everybody in this room has heard my speech on this subject for the last 12 years. And if they don't have it memorized by now, they have not been listening.

I commend you for holding these hearings. I think we have more than 20,000 pages of testimony on these issues. We will proceed, and I would just like to pledge to you that I haven't changed my mind one bit. Anything I can do to assist you, Mr. Chairman, in producing comprehensive legislation in these areas, I'm ready and willing to do.

I ask unanimous consent that 2 written statements be placed in the record at this point.

The CHAIRMAN. Without objection, so ordered.

STATEMENT OF SENATOR JAKE GARN

Senator GARN. Mr. Chairman, I commend you today for beginning this series of hearings on restructuring the regulation of the financial services industry. As you know, I firmly believe this restructuring is long overdue. Congress must recognize the changes that have occurred in the marketplace, and it must fashion new laws that acknowledge these changes while preserving the safety and soundness of the financial system.

Members of the committee may differ on what we think the regulatory system should look like. We certainly differ on whether the current banking bill promotes or inhibits truly significant reform. But what we agree on is that reform must take place.

Mr. Chairman, you and other members of this committee have repeatedly pledged to carry out this agreement before March of next year. If the Senate's version of the Banking bill passes, you have also pledged to let its moratoriums expire even if a comprehensive bill is not passed by then.

Mr. Chairman, let me join with you to work to achieve comprehensive reform. I will do everything I can to help you. But let me also say that if the "usual suspects" hold up this reform, I will expect this committee to let the moratoriums expire.

Let me now turn to another subject that today's events force me to address: FSLIC recap.

The time has come. Congress must stop fiddling with pet banking legislation while FSLIC burns.

The Washington Post reports this morning that record amounts have been and are being withdrawn from savings and loans. The Federal Home Loan Banks are running out of money to lend them because FSLIC is broke. The Federal Reserve is limited because it can only lend money secured by "good collateral," and most of the S&L's assets are already tied up as collateral for other loans. Southwestern S&L's are paying some of the highest deposit rates in the country, and still the big institutional investors and money brokers are steadily withdrawing funds. Even healthy institutions are being shunned by investors in what the Post calls a peculiar form of regional redlining. Regulators are now talking openly about liquidity problems and the need to merge the FSLIC and FDIC funds.

Why is all this happening? Because Congress has done nothing. Zero. Members claim that the regulators are crying wolf, but meanwhile the situation gets worse. The words of a Bank Board official in today's article perfectly sums up the congressional failure to act:

> It is dumb, it is irrational, it costs everybody—the weak thrifts, the good thrifts, FSLIC, the taxpayers, if there is ultimately a public bailout—more money to sit here and let the net operating losses grow this way.

We have been irresponsible and it's time to stop it. We can't wait until next week, or after the recess. We need to act now. The conferees could meet in one short session today and we could get a real rescue package to the President this week. Let's stop playing with fire. If we don't move now the taxpayer will be forced to foot the bill.

The CHAIRMAN. Senator D'Amato.

Senator D'AMATO. Thank you, Mr. Chairman.

Mr. Chairman, I have a longer statement that I would like to be placed in the record as if read in its entirety.

The CHAIRMAN. Without objection, it will be placed in the record in full.

Senator D'AMATO. I have a short statement that I would like to take the time to read because I think this is an important issue.

First, if we are attempting to restructure the financial services industry, the Congress should take the lead. Deregulation by disaster, as we have seen in the S&L industry, and deregulation by failure of certain regulatory agencies, such as the Comptroller, to implement and enforce the laws is just simply not acceptable.

Second, a final determination that comprehensive reform of the financial services industry is needed to stave off foreign competition must be made by the Congress. To date, the evidence on this point is rather inconclusive, notwithstanding certain statements that come from the Treasury.

As Federal Reserve Chairman Volcker stated before this committee:

> American firms are on the cutting edge of foreign competition. Further, the growth of foreign markets has been precipitated by factors other than the inability of our domestic institutions to compete at home or abroad.

Third, reform of this industry must be truly comprehensive. We shouldn't be paying lip service to the notion of comprehensive reform and continue to pass legislation creating built-in government-created advantages that favor some institutions and not others. I am basically saying if some of the institutions really want to get into expanded services, let them get out of the FDIC and don't permit them to set up an institution with an umbilical cord to the holding company under the guise of a so-called separate subsidiary. That's nonsense. If we're going to have true reform, and it may be time that we do it, then let's be realistic. But everybody wants to hold on to his advantage and say, "Let me get into the other guy's backyard." I think such posturing is nonsense and, Walter, you might smile, but I want to tell you something. You talk of good level playing field, but you don't really want it—it's human nature to seek advantages to the disadvantage of your competitors.

Fourth, if comprehensive reform is needed, then we should look, at least procedurally, at the British example. The British model basically overhauled the entire financial system and we should not reform our system on a piecemeal, stopgap basis that is an exercise in loophole closing in the guise of comprehensive reform.

Let me put it another way. Loophole closing or the piecemeal grant of powers is a way of just giving expanded powers to some, again under the guise of comprehensive reform, and it is not comprehensive reform.

Finally, I think that the Treasury plan outlined in the June 7, 1987, New York Times article, should not be a model for comprehensive reform. The idea of creating the superpower banks and somehow think that this is going to put us on the cutting edge, as the Japanese superpower banks, leaves a lot of things to be desired. That plan is a model for creating an oligarchical system in the financial services industry and would severely impair the process of capital formation in this country.

Further, it turns the procompetitive arguments for repealing certain provisions of Glass-Steagall and Bank Holding Acts on their heads. The Treasury now argues that these provisions must be repealed to create an oligarchical structure will be anti rather than procompetitive. Such large concentrations of wealth by a few institutions should be avoided rather than consciously created by the so-called comprehensive reform.

I look forward to this morning's testimony. I have a feeling that we could just about predict what's going to be said by the various proponents of the so-called reform and I don't believe it's really the kind of comprehensive reform that I would be willing to undertake.

Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator D'Amato.

Senator Wirth.

Senator **Wirth**. No comments, Mr. Chairman. Thank you.

The **Chairman**. At this point we shall place in the record statements of Senators D'Amato, Cranston, Dixon, Sasser, Sanford, Graham, and Karnes.

STATEMENT OF SENATOR ALFONSE M. D'AMATO

Senator **D'Amato**. I appreciate the witnesses' efforts in providing the committee with such thought provoking testimony.

Rather than read the entire statement into the record I'd like to make a few points.

First, if we are attempting to restructure the financial services industry, the Congress should take the lead. Deregulation by disaster as we have seen in the savings and loan industry and deregulation by the failure of certain regulatory agencies—such as the Comptroller—to implement and enforce the laws are not acceptable.

Second, a final determination that comprehensive reform of the financial services industry is needed to stave off foreign competition must be made by the Congress. To date, the evidence on this point is inconclusive. As Fed Chairman Volcker stated before this committee, American firms are on the cutting edge of foreign competition. Further, the growth of foreign markets has been precipitated by factors other than the inability of our domestic institutions to compete at home or abroad.

Third, reform of this industry must be truly comprehensive. We must not pay lip-service to the notion of comprehensive reform and continue to pass legislation creating built-in, Government-created advantages that favor some institutions and not others.

Fourth, if comprehensive reform is needed, then we should, at least procedurally, look to the British example. The British model basically overhauled the entire financial system. We should not reform our system on a piecemeal, stopgap basis that is an exercise in loophole closing in the guise of comprehensive reform.

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I look forward to this morning's testimony.

STATEMENT OF SENATOR ALAN CRANSTON

Senator Cranston. The Banking Committee in reporting out S. 790 made a commitment and set the stage for reassessing the underlining premise of the Glass-Steagall Act and other laws separating banking and commerce including the Bank and Thrift Holding Company Acts.

For too long, major public policy issues such as these have been decided not by the Congress but by clever lawyers exploiting loopholes for the benefit of their clients. We have over the years witnessed a frontal assault on the banking regulatory system by the Comptroller of the Currency who promoted the use of the nonbank bank loophole as a means to destroy the separation of banking and commerce and to promote nationwide interstate banking without agreement of Congress. This committee is rapidly approaching a conference on a bill to close the loopholes so that Congress will be in a position to go back and reshape our financial system before some of the court and market changes become irreversible.

It is apparent that there exists here today at least one consensus—that it is urgent that we move quickly to put competitive equality back into the U.S. financial system.

STATEMENT OF SENATOR ALAN DIXON

Senator Dixon. Mr. Chairman, I am pleased to be here this morning as the committee kicks off its hearings on comprehensive restructuring of the statutory framework governing the American banking industry, the securities industry, and other providers of financial services.

We have had a lot of hearings on these issues in the last 6½ years. We have listened to an almost endless parade of witnesses. We have failed in only one area—we haven't produced and enacted a reasonable and workable bill to bring financial services law into line with rapidly changing marketplace realities.

Instead, this committee and the full Senate, together with the relevant House committees and the full House of Representatives, have managed to avoid our responsibility—we have managed to avoid addressing issues that are long overdue for action. What's even worse, this avoidance was not accidental, nor was it due to circumstances beyond our control. Rather, it was intentional, based on the erroneous belief by some in Congress that inaction was a reasonable solution. Some believed—some continue to believe—that we can sit back and let the various segments of the financial services industry sort these problems and then come in and ratify the result.

I was pleased to see, therefore, that a majority of this committee committed to a comprehensive examination of financial restructuring issues when we considered S. 790 earlier this year. Many members of the Banking Committee were present 2 weeks ago when we took the first step in this process by holding a committee dinner attended by a number of leading experts in the field who could talk to the committee about what needs to be done.

This hearing is the beginning of the second step. I know it will be followed by a number of additional hearings over the next several weeks. I believe this morning's hearing and the hearings that will follow it are vitally important for at least two major reasons:

First, we have 7 new members of the committee in this Congress, 6 of which have not been able to attend our previous hearings in this area; and

Second, the entire committee needs to have a better factual understanding about what's going on in the United States and world financial services community.

I hope and expect, therefore, that this hearing, and the series of hearings that will follow, will provide us with the kind of factual background we need to make intelligent decisions about restructuring issues. We need these hearings to inform ourselves on issues, such as:

How we got where we are; the history behind the Glass-Steagall Act, the Bank Holding Company Act, and the other cornerstones of our regulatory scheme;

The consequences of failing to act; for example, what is the long-term future of the banking industry if there is no financial restructuring legislation;

How banks and other sectors of the banking industry make their money, how they made it 20 years ago, and how they are likely to make it 20 years from now;

The increasing "securitization" of financial services markets; and

The increasing "internationalization" of financial services markets.

This is not intended to be an inclusive list of issues we should cover. Rather, it is illustrative of the things we need to know in order to develop sound legislation. Importantly, we need to hear from more than just the providers of financial services. We need to hear, for example, from corporate treasurers as to why they use the Eurobond market. We need to know about the advantages of commercial paper over traditional lending from their point of view. We need to hear from State and local treasurers as to why they are making greater use of revenue bonds, and why they are increasingly utilizing foreign banks. In short, we need to hear from the users of bank services, as well as the providers.

As we begin these hearings, I want to again pledge my best efforts to see that the committee addresses the financial services restructuring issues in a timely way. As I said at the beginning of my remarks, I believe this action is long overdue and that we can no longer afford to wait.

I would like to conclude with one final point. I expect we can act before March 5, 1988. However, if we cannot, this is one Senator who will do everything he can to ensure that any moratorium that may be included as part of H.R. 27 is not extended. The moratorium was designed to give us time to act; it is not a substitute for action.

STATEMENT OF SENATOR JIM SASSER

Senator SASSER. Mr. Chairman, I wish to complement you on your leadership for beginning this important series of hearings on the changing structure of our financial system. When this committee reported S. 790, back in March, we said we would initiate a broad review of legal framework governing our financial services sector. We recognized that developments in the marketplace had far outpaced our existing laws. However, we decided that it was important that the committee have the time to consider these developments carefully. Too many of these changes have been haphazard and the result of loophole lawyers. These developments have increased competitive inequalities in the provision of financial services as well as risks to the deposit insurance and payments systems.

Mr. Chairman, I am hopeful that these hearings will be enlightening on how we should proceed on needed reforms to our financial system. We have much work to do—a strong, safe, and efficient financial system is our goal. I look forward to hearing today's testimony. Thank you.

OPENING STATEMENT OF SENATOR TERRY SANFORD

Senator SANFORD. Mr. Chairman, I commend you for calling this hearing and welcome our very distinguished panel of witnesses. I look forward to today's hearing and the additional hearings that will follow on comprehensive financial restructuring. As I stated during our debates on S. 790, I am committed to examining the many questions that a comprehensive reform of our financial services industry raises and to pushing for legislation that will place our financial services industry on a competitive footing.

I believe that the time has come to reform many of the laws governing our financial system. If we are to maintain an open, competitive capital market and to allow our financial firms the opportunity to compete on a fair basis with the tremendous foreign competition they now face, we must establish a procompetitive environment at home. We can no longer permit markets' developments, foreign actions and regulators' reforms to govern the future structure of our financial system.

I believe that we need to begin this process with some very fundamental questions: What do we want our financial system to look like when we finish the process? What long-term objectives should we keep in mind in mapping out a structure for our financial services? What—or whom—should our laws and regulations protect? Is there really a line between finance and commerce, and if so, should it be retained? I look forward to exploring the answers to these and other questions as we move forward with these hearings and as we examine the legislative proposals to follow.

I welcome these hearings because I think they will serve the very useful purpose of educating us as to just what is going on both in our capital markets and in the financial markets abroad. I believe that many of the changes that have taken place in recent years—

from the Big Bang in London to the securitization of our debt markets to the development of new and varied financial products—should be examined to determine their implications for the future of our financial system.

I hope that these hearings will allow us to examine just what role our laws should play in regulating financial services. In doing so, I am particularly hopeful that we will hear from a variety of consumers of financial services, ranging from city and county managers faced with needs to raise capital for municipal projects, to small and large businesses, to individual consumers. Because I believe that a large part of our role is to ensure that all types of consumers have fair and adequate access to competitive financial services, I believe that we must look at the needs of the great many users of our financial system, as well as the steps that must be taken to preserve the safety and soundness of that system.

Mr. Chairman, I commend your efforts in calling for these hearings and look forward to the information that they will provide as we begin the process of examining and restructuring our financial system.

OPENING STATEMENT OF SENATOR BOB GRAHAM

Senator **Graham**. Mr. Chairman, let me commend you for holding this morning's hearing in such a timely fashion. We face a tremendous challenge today in the financial industry, our financial systems are based on old monetary realities and they are struggling to cope with a new world of rapidly expanding economies and overnight changes. It is time we reviewed our financial industry. It's time we reassert ourselves as world financial leaders and recapture the momentum in our domestic market.

I've been a member of the Senate Banking Committee for 5 months now. I won't pretend to you that I have all the answers. But I've done enough listening to know what some of the questions are:

First, what are the forces that are driving change in the financial services industry?

Second, if those forces go unimpeded or unaccelerated by governmental action, where are they likely to lead us?

Third, is that where we want to go?

Fourth, if not, what would be in the best interests of America—of the users of financial services—of the providers of those services—of the general public?

Fifth, what should the Federal Government do to help us to reach our financial goals?

We have some of the answers already:

First, the forces driving the industry are requirements to meet market competition in terms of profits or dividends to stockholders and interest rate charges to customers.

Second, the field has been complicated by the aggressive entrepreneurship which is blurring the lines that used to separate financial institutions.

Third, the new phenomenon of "securitization" has altered the way we deal with business capitalization.

Fourth, in some States, such as Florida, nonbank banks have targeted profitable markets and threatened traditional banking's dominance of some parts of the money business.

Fifth, international competition for the U.S. market has intensified.

If we do nothing, all those driving forces may lead us to an unhealthy domestic uncertainty and a pronounced reticence to make longterm commitments and decisions. Meanwhile, foreign competition from European and Japanese financial institutions is establishing increasing influence and presence in the U.S. domestic market.

The end result could be a replication of what has happened in other significant areas of the American economy—a declining share of our own domestic market.

Unquestionably we'd all like America to be in control of its destiny, as part of our overall financial strategy we want American economic institutions—whether they are financial, industrial, agricultural, or others—to be comfortable making longterm decisions and commitments—to have a sense of confidence sufficient to make investments for the future.

Perhaps more than in any other industry, our finance industry is crucial to our national stability and security, our financial structure supports the rest of our capitalistic system, present concerns about the health and longevity of that system are entirely justified and send disturbing vibrations throughout the rest of the American economy.

We don't have the answers to all the questions, but we have a sense of how grave those questions are and how open the possibilities are for change. Americans have always displayed a dauntless ability to seize the moment. I am glad to see that the Banking Committee is wasting no time addressing the current challenges facing us in the financial industry and I look forward to hearing from our very distinguished witnesses this morning.

STATEMENT OF SENATOR DAVID KARNES

Senator **Karnes**. Mr. Chairman, good morning. First let me take this opportunity to commend you Mr. Chairman for your effort in keeping a dialog on the comprehensive financial restructuring going. As one of the newest members of this distinguished committee, I look forward with great anticipation to the testimony of our knowledgeable panel regarding the subject of where our financial industry is going. I am particularly interested in this subject and hope that with my prior experience in several financial arenas, before joining the U.S. Senate, that I can make a significant contribution to these committee deliberations.

There are many factors, both domestic and international, which continue to produce changes in our financial system. Forces such as the increasing foreign investment in American capital markets, the recent decline in the U.S. dollar, the increasing budget and trade deficits and numerous others which are impacting our financial system. These combined forces are producing a new type of financial system which presents new legal and policy issues which the Congress must face.

We must determine whether our present policies are adequate to provide for the safety and soundness of all parties involved in the financial services community, and if not, how we address these shortcomings. We must address the issue of the separation of commerce and industry and the separation of commercial banking and investment banking. We need to review the effectiveness, and the profitability outlook of the banking and securities industry under the current legal framework. I hope we can determine the U.S. financial industry's ability to compete in the international marketplace, review the expanded bank powers question, and attempt to establish a course for how our regulatory agencies should function under the new financial environment. The decisions we make and the course of action we take as a result of these deliberations could have a profound and lasting impact on the financial service community as we know it.

Mr. Chairman, the past several years have been very trying times for the financial service industry in Nebraska having to deal with an unprecedented agricultural crisis, with continued deregulation, volatile interest rates, and new competition from the nonbank banks.

I hope the committee, in its deliberations, will be mindful of the need to maintain a framework for a steady and reliable source of credit for the consumer-homeowner, farmer, and commercial business in addition to providing a competitive marketplace for the wide spectrum of financial products now utilized by the American consumer.

The **Chairman**. Mr. Corrigan, you're the first witness. I'm going to ask if you gentlemen will confine your remarks to 10 minutes or less. Your statements are all excellent statements and we will print them in full in the record. So if you can abbreviate your statements and keep them down to 10 minutes we would appreciate it very much. The green light is the go ahead light and the red light is the stop light.

STATEMENT OF E. GERALD CORRIGAN, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK, NEW YORK, NY

Mr. **Corrigan**. I will try to honor your request to be brief. I will simply say at the outset, Mr. Chairman, as I see it, few issues before this committee or the Congress more generally are more pressing in my view than is the subject of broad-based reform of our financial system.

I would ask that my statement and several things referred to in it be submitted for the record.

The **Chairman**. It will be printed in full.

Mr. **Corrigan**. I would observe that if we are to have a measure of success in getting on with this task of reform, I think it's important that all participants to the process show a greater capacity to rise above parochial interests than I have observed in the past.

I and I think all recognize—I think it's interesting that Adam Smith had this point of view—that there are basic public policy considerations associated with the structure and operation of the banking financial system and that is my starting point.

OBJECTIVES OF REFORM

I think as we talk about reform, as I see it, the objectives of reform can be reduced to three. They are very straightforward.

First, I think we want a system in which our scarce financial resources are mobilized and allocated in the most efficient and cost-effective manner possible.

Second, we want a system in which the impartiality of all elements of the credit process are preserved, if not enhanced.

Third, we want a system that is strong enough to withstand shocks, disruptions, and failures in its component parts, even if the component part in question is large. This latter consideration I think is of some particular importance in a setting in which at least some observers seem to believe that the system is more fragile or more accident prone than it should be or than it need be.

As an extension of that, we also want a banking and financial system which is strong enough to serve as the transmission vehicle through which monetary policy operates on the economy at large.

As the committee knows, I have suggested an approach to satisfying those goals as I see them. I'm not going to go into that in any detail at all except to make one quick point. And that is, it would permit common corporate ownership of a wide range of financial entities and it is a two-way street. It would permit banks to do more things, but it would also permit financial firms, including securities firms, to own and control banks.

I think, at least in my judgment, it does satisfy the two major considerations as I see it. One is coming to grips with competitive realities here and around the world, and the second is satisfying ourselves that the underlying strength of the system as a whole is as good as it can be and should be.

SEPARATION OF BANKING AND COMMERCE

In my statement, Mr. Chairman, I also talk at some length about this question of the separation of banking and commerce. I have spent literally countless hours debating the wisdom of maintaining a separation of banking from commerce and let me define these terms specifically.

What I mean is, should we as a matter of law have a system in which we are going to permit corporations of any size, shape or form to own and control banks? That's the issue.

Now having spent a considerable amount of time debating that question, I can say, Mr. Chairman, that if my views have changed, they have changed in the direction of further solidifying my judgment that it is in the public interest to have a legislative framework that prevents commercial firms from owning and controlling banks unless there is some absolutely compelling reason to permit such combinations.

Since I see no such compelling reason at this time, I remain opposed to those arrangements. I think that the issues involved here really come down to two elements of risk to public interest. The first set of risks are historic concerns about concentration, conflicts, unfair competition, and breaches of fiduciary responsibilities. Indeed, I would note that even most proponents of blending banking and commerce acknowledge those risks are present.

In response to this, those proponents suggest that the problem can be dealt with by regulation. However, if regulation is to be effective, it seems to me that by definition it will eliminate the very synergies which make such combinations of interest in the first place. Indeed, if all that is at stake is the capacity of a corporation to make a passive investment in a bank or a financial firm, there is nothing to prevent them from doing that in great size right now.

A second thing that I think is even more important that we should consider here is it seems quite clear to me that merging banking and commerce brings with it the danger that we will have a de facto extension of parts of the safety net surrounding banking and finance to any firm that would own and control banks.

Again, in response to that point, the proponents say that it's really no different than what we have right now with a bank holding company.

In fact, there is a very big difference. That difference is that the bank holding company as an integrative whole is subject to official supervision.

I think there is another very practical way to look at the problem and that is I assume that even the proponents of merging banking and commerce would agree that the acquisition of a bank by a commercial company would have to be subject to some sort of official review process. I assume they would also agree that as a part of the application process it would involve looking at the financial strength of the acquiring firm and the regulatory or managerial firewalls that they agree should be constructed.

I assume they further agree that some such applications would be approved and others denied. Now in making that point, I think it must be emphasized that commercial firms wishing to own banks undoubtedly will not be limited to a few blue chip companies. To the contrary, the list of potential acquirers will include all commercial firms, something I am convinced we should be especially sensitive to in this era of merger mania in which even solid firms can be forced into elaborate defensive financial strategies which undermine their balance sheets.

Therein lies the dilemma, as I see it, in that even the act of an official approval of an application of a commercial firm to acquire a bank seems to carry with it the extension of at least parts of the official safety net to the acquiring firm.

As I see it, this subtle but certain extension of the safety net is not something we should take lightly. Indeed, at the extreme, the logic of the matter says to me that if the bank cannot be fully insulated from the corporation as a whole, the consequences and the logic are, first, that either the safety net surrounding banking will have to be extended by implication to all who would own and control banks, or we ought to get rid of the safety net altogether.

I think at the end of the day it's that simple. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Corrigan.

[The complete prepared statement of E. Gerald Corrigan follows:]

STATEMENT BY

E. GERALD CORRIGAN

PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK

Mr. Chairman, members of the Committee, I am pleased to have this opportunity to appear before you today to discuss broad-based reform of our banking and financial system. In my judgment, few issues before the Committee or before the Congress generally are more pressing or more important than is the subject of these hearings. Many of the issues and questions raised in your letter of invitation have been covered in my recent essay, Financial Market Structure: A Longer View, and in a major study on bank profitability completed by the Federal Reserve Bank of New York last year. Accordingly, I would ask that both of these documents be submitted for the record. I should also say at the outset that I am appearing here today in a personal capacity and not on behalf of the Federal Reserve System.

I approach the subject matter of these hearings with a deep conviction that participants in the process must rise above parochial interests. Indeed, to the extent that firms, groups of firms and their lobbyists continue to approach the process of banking and financial reform with the "winner-take-all" mentality that has been all too evident in the past, there will be no winners. What is fundamentally at issue here is not a turf war but rather how we as a nation can best see to it that legitimate public interest considerations associated with a safe, efficient and impartial banking and financial system are well served. I, for one, believe that goal is within reach, but I also believe that time and events are not in our favor. Indeed, the longer we wait, the more difficult the task becomes, and the greater the risks that an unpleasant surprise will intervene. As we all know, in such circumstances efforts aimed at reform can quickly take on a regressive, rather than a progressive, character.

I. The Case for Reform

As I see it, the case for fundamental reform in our banking and financial system is compelling. The speed and scope of change we are seeing in our financial markets and institutions have taken on a revolutionary character. But, revolutions do not occur in a vacuum -- they have their causes. In this particular case, many of the causes are to be found in patterns of economic performance here and around the world over the past decade or more. Over the same time frame, changing technology and innovation have fostered the application of very sophisticated forms of mathematics and computer technology to the financial marketplace, making possible the design of new techniques, new instruments, and worldwide trading and funding strategies. These developments have worked to highlight longstanding differences in

supervisory, tax, accounting and regulatory treatment of classes of institutions here and abroad, thereby further sharpening competitive differences and incentives for patterns of behavior which exploit loopholes and circumvent supervisory policies. Thus, while it is beyond debate that the process of change and innovation has brought with it important benefits, there persists a nagging sense of unease -- a sense of unease that is prevalent among financial market practitioners themselves -- that all is not well. To some considerable extent, that sense of unease seems to grow out of the concern that legitimate broad-based public interest considerations about the structure and stability of financial markets and institutions are being swept aside in a helter skelter of events that lacks an underlying sense of direction and may be weakening the system.

In considering this crosscurrent of events and circumstances that is at work in the financial marketplace, there is one further point that should be raised. Namely, there is also the subtle danger that the developments we are witnessing -- at least at the margin -- are being reinforced by a belief that the public safety net associated with banking and finance will protect not just the system as a whole but also all of its individual component parts, including those who have acted in an irresponsible and undisciplined manner. To the extent that perception exists it must be changed, for of all the freedoms contemplated by the current environment, the freedom to fail must be part of the equation. To put it differently, we simply cannot have a financial system in which even a few participants seem to believe that standards of behavior start with the maximization of profits and end with the socialization of losses.

II. Banking, Finance and the Public Interest

For decades, indeed for centuries, it has been recognized that there are characteristics associated with banking and finance that warrant a higher level of official supervision than is associated with most other forms of commercial enterprise. In this regard it should be of more than casual interest to note that one of the earliest and strongest voices for the regulation of banking was none other than Adam Smith writing in the Wealth of Nations. Even in this age of deregulation, the central question before us is not whether the banking and financial system should be subject to official supervisory oversight but rather how we strike an appropriate and reasonable balance between the dictates of competition and efficiency on the one hand and safety and integrity on the other.

Seeking to achieve that necessary balance in current circumstances runs afoul of many practical difficulties but it also is hampered by an intellectual barrier. Namely, in looking at the particular functions of the banking and financial system which are of special importance in a public policy perspective, there is something of a natural tendency to take their significance for granted and to look at them in isolation.

That is, there is a tendency to say there is nothing unique or special about extending credit; nothing unique or special about making or receiving payments; or, nothing unique or special about issuing transaction or demand balances. The difficulty, of course, is that these functions cannot be looked at in isolation but rather, must be viewed as something of a trilogy -- the unifying force for which is that the system as a whole is a credit system in which very large amounts of claims on financial institutions must be satisfied on demand or on very short notice. Those claims include not just the stock of conventional "demand" deposits housed in depository institutions but also the hundreds of billions of dollars in debit and credit entries made daily that are now associated with our highly integrated financial markets on a worldwide basis. Therefore, each institution in the loop must not only satisfy itself that it is making all of its credit judgments in a rigorous and objective manner, but it must also have confidence that others to whom it may be indirectly exposed are doing the same. For these reasons, and because the business of banking and finance is essentially the business of public and mutual confidence, the public at large and market participants more specifically have expected and demanded a degree of official surveillance over the system -- a system in which credit and credibility are the unifying forces.

III. The Process of Reform: Overall Objectives

While the details of efforts aimed at financial reform are very complex, it seems to me that the objectives of reform are quite straightforward and reduce to only three key elements:

First, we want a market-driven system in which our scarce financial resources are mobilized and allocated in the most efficient and cost-effective manner.

Second, we want a system in which the impartiality of all elements of the credit decision-making process is preserved if not enhanced.

Third, we want a system which is strong enough to withstand shocks, disruptions and failures in its component parts, even if the component part in question is large. This latter consideration is of particular importance in a setting in which some observers believe that the system is more fragile or more accident-prone than it should be or than it need be. As an extension of this, we also want a banking and financial system which is strong enough to serve as the transmission vehicle through which monetary policy influences overall economic activity.

In considering how to translate those broad objectives into a series of operational principles, I believe we must keep several related points in mind. These include:

First, the capital resources needed to safely support banking and financial enterprises will only be forthcoming to the extent the returns on that capital are high enough to attract capital resources from alternative and competing uses.

Second, given the realities of global financial markets, the structure we choose to adopt here must at least be sensitive to arrangements elsewhere. In that regard it should be stressed that with changes now taking place in the U.K. and Canada, the United States and Japan are the only remaining major countries that do not permit rather generalized blending of banking and other financial enterprises within the same corporate entity.

Third, contrary to segments of opinion, concerns about the stability of the system are not limited to problems at large institutions. To be sure, problems at large institutions are often more difficult to deal with and will generally entail systemic considerations. But, let me remind the Committee that in 1985 we experienced a chain of events that were threatening indeed, even though "major" institutions were not a direct part of the problem.

That chain of events began with the failure of a small Florida securities firm, which, then (1) spread to Ohio where it unleashed the Ohio thrift crisis, (2) triggered the failure of a second small securities firm which in turn, (3) resulted in circumstances which came very close to putting the entire market for mortgage-backed securities into gridlock, and (4) produced the Maryland thrift crisis including its spillover into certain real estate firms which in turn threatened the well-being of several important mortgage insurance companies.

Fourth, while we can draw comfort from the enhancements to the financial safety net that have been put in place over the past several decades, we should not allow that sense of comfort to delude us into thinking that arrangements that were conceived in the past are necessarily sufficient for the present, much less the future. In this regard I would want to emphasize that the speed, volume and complexity of contemporary financial markets are of a very different order of magnitude than they were even a decade ago, as is the nature of the worldwide operational, liquidity and credit interdependencies that grow out of these arrangements. When I see days in which the electronic payments flowing through the Federal Reserve Bank of New York exceed $1.5 trillion -- something I see with some frequency-- the realities of these worldwide interdependencies are very vivid indeed.

IV. The Process of Reform: Guiding Principles

In my own thinking about a practical approach to reform of the financial system, I have given important weight to six guiding principles which, as I see it, flow out of the broad objectives mentioned above. These guiding principles are as follows:

- First, the separation of "banking" from commerce should be preserved.

- Second, in the interest of competitive equity and supervisory harmony, the regulatory costs associated with special "banking" functions should, to the fullest extent possible, be neutralized or eliminated across classes of institutions.

- Third, the approach should provide scope for achieving the benefits of greater competition in the marketplace for financial services while preserving the important public benefits growing out of an appropriate degree of supervisory oversight of the system.

- Fourth, supervision should take account of function, not merely institutional form.

- Fifth, the structure of the system should incorporate principles of "volunteerism" whereby individual firms can choose their position on the financial landscape based on their own corporate strategies and their own assessments of the costs and benefits of one form of corporate organization over others.

- Sixth, and most importantly, the approach should strengthen the stability and soundness of the system in part by providing greater room for self- and market-discipline but also by enhancing the strength and flexibility of the official supervisory apparatus where necessary.

Building on these principles, the structure I have suggested can be summarized as follows:

- First, the approach would maintain a basic separation between banking and commerce while permitting firms engaged in providing financial services to operate in a broad range of banking and financial product and service markets. That is, common corporate ownership of banks, thrifts, insurance companies, and securities companies would be permitted -- subject to appropriate regulatory restraints -- as would combinations of commercial firms and nonbank financial concerns. However, commercial firms could not own and control insured depositories. On the other hand, securities, insurance or other financial concerns could own and control insured depositories subject, of course, to appropriate supervisory policies. The approach is fully consistent with the view that "banks are special" while at the same time sensitive to the market realities associated with the provision of financial services in a contemporary setting here and abroad.

- Second, the approach recognizes that competitive realities require that artificial distinctions between classes of financial institutions offering functionally similar financial services must be narrowed, especially as they pertain to those financial services which are of particular concern from a public policy perspective. Accordingly, the proposals would:
  - eliminate the prohibition against paying interest on transaction deposits.
  - provide for the payment of interest on required reserves.
  - make all transaction accounts subject to required reserves.
  - eliminate required reserves on nonpersonal time deposits.
  - establish an interest-earning liquidity reserve applicable to all major direct participants in the large-dollar electronic payments network.
  - broaden the class of institutions that have some form of direct access to the payments mechanism and the discount window.
  - broaden the class of integrated financial institutions that are subject to a degree of consolidated official supervision by the Federal Reserve.

- Third, the approach would also usher in a greater degree of more balanced competition in the marketplace for banking and financial services. Indeed, by permitting combinations of financial and banking entities in a setting in which commercial firms may continue to offer a full range of nonbank financial services, the thrust of competitive forces would be driven more by market considerations. However, all of this would take place in a framework in which the supervisory apparatus associated with banking and finance would be preserved and enhanced. And, it would also be possible to phase in such arrangements over a period of time in a manner not unlike that in which regulation Q ceilings were reduced and then eliminated over a period of time under the provisions of the 1980 Monetary Control Act.

- Fourth, official supervision would increasingly take account of function, not merely form. This goal is achieved in several ways, including by virtue of the steps outlined in the second item above. Beyond those particular suggestions, the approach also contemplates:
  - the adoption of risk-based capital standards for U.S. banking organizations which would permit a convergence in such standards between U.S. banks and foreign banks and over time would also be conceptually compatible with the goal of achieving a greater degree of convergence in capital requirements as among like classes of activities in banks and other financial entities.
  - the creation of an interagency "Financial Services Oversight Board" to insure, among other things, that a uniform definition of financial services is applied to all classes of banking and financial entities.

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  - that component parts of bank, thrift and financial holding companies would be subject to direct institutional supervision in much the same fashion as is the case today but against a set of functionally based prudential and customer protection standards.

  - that any financial organization that has access to the discount window and is a major user of the large-dollar electronic payments system would be subject to a degree of consolidated supervision by the Federal Reserve.

- Fifth, taken as a whole, the proposals provide for a high degree of choice or "volunteerism" on the part of individual business enterprises. That is, any firm that wishes to be in the business of providing banking or financial services has clear options available to it depending on how that firm weighs the costs and benefits of one corporate form versus others. Beyond that, and within each major category of enterprise, the firm would have considerable discretion -- subject, of course, to appropriate regulatory restraints -- to choose the specific types and forms of services it might wish to provide. And, it would also be possible for firms to shift from one category to another recognizing, of course, that a bank or financial firm that was acquired by a commercial firm or that chose to enter commercial lines of business would have to divest any depositories it owned.

While all of the above considerations are important, the acid test of the approach is whether it would work in the direction of reducing systemic risk while at the same time leaving ample room for market discipline to play its necessary and appropriate role. Insofar as the stability of the system as a whole is

concerned, there are several aspects of these proposals which clearly work in the direction of reducing vulnerabilities. For example:

- the narrowing of artificial distinctions among classes of financial institutions would work in the direction of reducing inhibitions on the regulatory side in calling for stronger prudential standards in such areas as capital adequacy.

- The incentives to move activities offshore or to the point of least supervisory purview would be reduced.

- The payment of interest on demand deposits and reserves would reduce the incentives for intraday and day-to-day churning in financial markets.

- The liquidity reserve would increase the cushion of cash balances in the system, thereby reducing intraday credit exposure and providing a thicker liquidity cushion -- short of the central bank -- for individual institutions and for the system as a whole.

- More open access to the payments system and finality of payment in large-dollar electronic payments systems would reduce the systemic risks in the payments system while also working in the direction of isolating problems at their source which, in turn, would provide a degree of greater flexibility in official responses to problems if and when they arise.

- providing for a degree of consolidated supervision of diversified financial firms would appreciably narrow a major gap in the official supervisory network.

In considering the factors outlined above, the most difficult question is not whether they will work in the direction of strengthening the system but rather whether they might work too well. By that, of course, I mean that there is always a danger that they will be perceived merely as extending the "safety net" and thus running the risk that the result will be a further erosion of discipline in the marketplace, since market participants may conclude that the safety net will protect not just the system but all of its component parts, even those who have acted in an irresponsible or undisciplined fashion. As I said earlier, that perception, to the extent it does or might exist, must be changed. To repeat, the freedoms contemplated by the current market environment must include the freedom to fail. And, by extension, the financial system must be a system in which discipline operates through prior restraints -- saying "no" to unduly risky activities and transactions -- and not by falling into situations in which restraint and discipline are achieved only as a by-product of instability and failure.

V. The Separation of Banking and Commerce

While the current debate regarding reform of the banking and financial system has many controversial aspects, one source of debate that is especially crucial to the deliberations of the Congress relates to whether, as a matter of public policy, we should preserve a separation between banking and commerce.

I have spent countless hours deliberating the wisdom of maintaining the separation of banking from commerce. Having done that, I can say, Mr. Chairman, that if my views have changed, they have changed in the direction of further solidifying my judgment that it is in the public interest to have a legislative framework that prevents commercial firms from owning and controlling banks unless there is some absolutely compelling reason to permit such combinations. Since I see no such compelling reason at this time, I remain opposed to such arrangements.

The case for permitting commercial firms to own and control banks is based on a view that says either that there is nothing inherently wrong with such combinations or that such combinations can provide economic benefits in a framework in which regulatory and/or managerial protections can be put in place that will insure that public interest considerations are adequately served. I, for one, have grave doubts on both accounts. In order to make that case, let me begin with several points of reference.

First, when society vests with a select group of institutions certain privileges such as deposit insurance, access to the payments, credit and liquidity facilities of the central bank and the implicit sanctions of official supervision, something of a social compact is created whereby the institution accepts certain responsibilities, most notably the responsibility to conduct its affairs in a safe, prudent and impartial manner.

Second, the central question at issue with respect to the banking-commerce separation doctrine is whether it is desirable for wholly unregulated, unsupervised commercial concerns to be able to own and control depositories having access to the overall Federal financial safety net. In seeking to answer the question we should, for starters, keep in mind that if we in the U.S. go that route, such arrangements would be unusual among the industrial countries of the world in that in no other major countries are banks, as a general matter, owned and controlled by commercial companies. To be sure, in some countries, such as Germany, banks have greater flexibility in the extent to which they may hold equity interests in commercial companies than is the case in the U.S., but commercial ownership and control of banks are not common.

Third, if, as a legal matter, commercial concerns are able to own and control banks, it seems apt to ask would they choose to do so and if so, why? To some extent we know the answer to the first question since at least some commercial firms already own insured depositories and others seem to have an interest in doing so. In that setting, the operative question is why they would wish to do so. Here there can be only three possible answers. First, among the alternative uses of capital, they visualize the relative returns available in banking as superior; second, they see synergies in the combination of banking with existing lines of business that will permit them to maximize the overall return on capital; or, third, they see economic advantages in gaining access to one or more of the privileges associated with banking such as access to the market for insured deposits or direct access to the payment system. Of course in reality, the motivation might well reflect some combination of the above factors. The key point, however, is that if the motivation for commercial companies to own banks is even partly related to the second and/or third explanations cited above, there are clear dangers in permitting such combinations.

Fourth, one might be more inclined to run those risks if there is some absolutely compelling public policy reason to do so. Satisfying the business interests of a relative handful of corporations does not strike me as a compelling public purpose. On the other hand, if there was (1) strong evidence of an absence of competition in banking or (2) strong evidence that combinations of banking and commercial concerns would unleash powerful new economies of scale which did not run afoul of public interest considerations, or (3) if the banking industry was suffering a chronic shortage of capital, one would look at banking and commerce in a different light.

While a case can be made that the capital base of the banking industry should be further bolstered, it is by no means clear that the only way, or the best way, to remedy that problem lies with permitting commercial firms to acquire and control insured depositories. Indeed, it is not even clear that permitting commercial firms to make such investments would materially augment the true capital base of the banking industry. Whether, and the extent to which, that result is achieved would depend, among other things, on the nature of such investments, the prices paid and the manner in which the investment is financed by the commercial company. More importantly, at the end of the day capital will be attracted only by underlying profitability. Merely permitting commercial ownership of banks would seem to do little to change that unless the owners were permitted to push extensive interrelationships which is the very source of my concern.

Fifth, a final consideration which is of relevance in evaluating the case for or against the separation of banking and commerce is the rather straightforward matter of how businesses conduct their affairs. That is, when we look at the manner in which large diversified bank holding companies, financial conglomerates or even commercial-financial firms are managed, do we see -- especially in times of stress -- an integrated approach to management, or do we see parents and offspring each willing and able to go its own way even when one or the other is faced with adversity?

While some observers cite a limited number of examples which they believe provide evidence of failsafe managerial firewalls, I believe that any objective examination of the evidence -- evidence that runs the gamut from advertising to episodes in which firms have taken large losses even in the face of ambiguities about their legal liability -- leads conclusively to the view that firewalls are not failsafe and that, far more often than not, large financial concerns are managed and operated as consolidated entities. Looked at differently, the mere need to set up an elaborate system of firewalls says something about the basic issue of whether it makes good sense to prompt such combinations in the first place.

Taking all of those considerations into account, there are two major classes of risks that must be considered if we are prepared to permit the blending of commerce and banking. The first set of risks are the historic concerns about concentration, conflicts, unfair competition and breaches of fiduciary responsibilities. Interestingly enough, even most proponents of blending banking and commerce acknowledge that those risks are present. In response to this, the proponents suggest that the problem can be dealt with by regulation. However, if regulation is effective, it will, by definition, eliminate the synergies of any such combination such that the commercial firm in question is left only with a truly passive investment. If that is the objective of the commercial firm, there is nothing to prevent such firms from making large equity investments via the open market in any number of banking or financial entities so long as any one such investment does not achieve control over the company in question. Indeed, a commercial firm can buy up to five percent of the stock in any one bank without even having to disclose such an investment.

The second set of risks associated with permitting the merging of banking and commerce are the dangers that such arrangements will involve the de-facto extension of parts of the safety net to any firm that would own and control banks. In response to this point, the proponents argue that the situation is really no different than the situation we have today with the bank holding company. In fact, there is a very big difference and that difference is that the bank holding company -- as an integrated whole -- is subject to official supervision. Moreover, in the reform plan I have suggested, all component parts of a bank or financial holding company would be subject to some form of official supervision, much as they are today, and the company as a whole would be subject to at least a degree of consolidated official supervision.

There is another way to look at the problem. Namely, I assume that even the proponents of merging banking and commerce would agree that the acquisition of a bank by a commercial company would be subject to some sort of official approval process. I assume they would also agree that a part of that application process would have to focus on the financial strength of the acquiring firm as well as the regulatory and managerial firewalls which they agree should be constructed. I assume they would further agree that some such applications would be approved while others would be denied and that some form of ongoing monitoring would be necessary. In making this point, it should be emphasized that commercial firms wishing to own banks undoubtedly will not be limited to a few "blue chip" companies. To the contrary, the list of potential acquirers will include all comers -- something I am convinced we should be especially sensitive to in this era of merger mania in which even solid firms can be forced into elaborate defensive financial strategies which undermine their balance sheets.

Therein, of course, lies the dilemma; that is, even the official act of approving an application of a commercial firm to acquire a bank seems to carry with it the extension of at least some elements of official

oversight to the acquiring firm in a manner which brings with it -- at least by implication -- an official blessing of the transaction and the relationship in question. As I see it, this subtle but certain extension of the safety net is not something we should take lightly since we must be prepared to live with the consequences in foul weather as well as in fair. Indeed, at the extreme the logic of the matter is unavoidable; if the bank cannot be fully insulated from the entity as a whole, the consequences are either that (1) the safety net surrounding banking will have to be extended -- at least to an extent -- to all who would own and control banks, or (2) the safety net should be eliminated altogether.

VI. Supervisory Considerations

In concluding, allow me to make a few brief comments on supervisory considerations most of which are discussed in greater detail in my essay

First, while there is a strong case for regulatory reform in banking and finance, it would be counter-productive to seek to legislate such reform until we know how the structure of the system itself will evolve, legislatively or otherwise.

Second, if a financial structure reform proposal along the broad lines I have suggested were to be put in place, only relatively minor changes in the regulatory apparatus need accompany that process in the first instance.

Third, I believe that legislation aimed at simplifying and streamlining the administrative and related procedures of the Bank Holding Company Act along the lines included in S.2858 which was passed by the Senate in September 1984 is an important priority in its own right. Indeed, these provisions, especially in a context in which product and service options for banking organizations were broadened, would greatly ease regulatory tasks for banks and for the Federal Reserve alike.

Fourth, I strongly believe that major banking or financial firms -- especially those having direct access to the central bank's payments, liquidity and credit facilities -- should be subject to at least a degree of consolidated supervisory oversight by the central bank. Indeed, even with a strengthened Section 23A of the Federal Reserve Act, the nature of intra-company transactions and interdependencies are such that a degree of consolidated supervision of the entity as a whole strikes me as an essential component of any well-designed supervisory apparatus.

Finally, banking and financial supervisory policy is going to have to move faster and further in the direction of international convergence but also in the direction of insuring that like activities are subject to the same capital and other prudential standards regardless of where in a corporate entity those activities are conducted or booked.

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The CHAIRMAN. Mr. Wriston.

STATEMENT OF WALTER B. WRISTON, FORMER CHAIRMAN, CITICORP, NEW YORK, NY

Mr. WRISTON. Mr. Chairman, thank you for the opportunity to be here this morning.

In thinking about any problem and this one in particular, I think the first thing is to try to separate the shadow from the reality lest we try to solve the wrong problem.

In political terms, the best illustration of this state of affairs is the electoral college. Everybody knows that the President is elected by delegates chosen for the electoral college, but the reality is that we all learn the name of our next President on the evening news broadcast weeks before the college ever meets.

POLITICAL MARKETPLACE OVERTAKES FEDERAL LEGAL FRAMEWORK

The Federal legal framework is untouched and functioning, but the reality of the political marketplace has overtaken it. The financial service business is also subject to this same shadow and reality phenomenon. Federal laws and regulations are in place which might lead one to one conclusion, while the reality of the marketplace is quite different. There are a lot of commonly articulated positions which have little basis in today's world. Examples abound.

One, on all sides, one can hear that there is a traditional, longstanding legal separation of commerce from finance in America, but that is the shadow and not the reality. The debate about this unreal shadow world does not affect our daily lives. In the real world, companies selling merchandise, building airplanes, drilling for oil in the North Sea, making cars and trucks—all clearly lines of commerce—own and are in the financial service business in a very, very big way.

The Federal law in this respect is a one-way street. Banks as insitutions cannot engage in commerce, but commerce can engage in financial services. In the real world, however, banking and commerce have never been separate in American history. Since the 18th century, banking and commerce have been united in law and in practice, directly or indirectly, through affiliations on a personal or corporate basis. Whatever restrictions have been placed on banks as institutions, owners of banks have always engaged in all types of businesses.

Wells Fargo & Company combined banking with the stagecoach business. Indeed, the California law at that time practically required banking to be united with commercial firms. On a personal level today, Joe Allbritton owns control of and is a CEO of the Riggs National Bank across town, and he also owns 5 television stations. In New York City, a company chartered in 1799 to supply water to the city of New York founded and owned and was the forerunner of the Chase Manhattan Bank. The list is almost endless.

The further reality is that no one has ever articulated an agreed-upon definition of either banking or commerce. Indeed, the Supreme Court ruled that banking itself is commerce as recently as 1985. On the other hand, so far as I know, there is no unique definition of commerce. It is hard to argue that it is injurious to the health of banks to own some company engaged in a line of commerce, but good for the maker of steel or automobiles to own a financial service business.

The reality is that most of us do not know who owns our friendly neighborhood lender, nor do we care as long as our needs are met. If GMAC offers the consumer 3.9 percent interest rate on a car loan and our local friend commercial banker quotes 9 percent, the fact that General Motors is making the loan and not our local banker does not really enter into the consumer's equation.

Two, another issue of shadow and reality is the question of interstate banking. For years, this issue has divided the industry and the politicians. It is no longer an issue even though one hears echoes of the old rhetoric in hotel ballrooms across the land. The facts are that the States have taken over and solved the problem because Congress would not address this issue.

RECIPROCAL BANKING PRIVILEGES

Of the 50 States in the union, 44 and the District of Columbia currently offer some kind of reciprocal banking privileges to out-of-state American banks. These range in terms from total freedom of entry today to freedom of entry at some date certain in the future, to entry only within defined limited terms.

In the real world, the Federal system of Government worked, and the problem is all but solved by the action of individual States. In short, the 9th and 10th amendments to the Constitution are in full force and effect.

Three, another issue of shadow and reality is the so-called nonbank bank. As we have all learned by now, the nonbank bank is a nonissue issue. The institutions are performing a valid function in our economy and they never did pose any threat to anything, except possibly some entrenched monopoly protecting its position.

Four, another shadow issue is that the American market for financial services is separate from the rest of the world. The reality is that the American market, large as it is, is just one part of the global marketplace, and today capital flows overwhelm trade. It is a matter of complete indifference to a major corporation whether it raised money either in debt or in equity in New York or London or Tokyo. All the corporate consumer wants is the best deal available in the marketplace. To think that we can isolate the U.S. institutions from the rest of the world is nostalgia, but it's not reality.

Five, the rhetoric is that one can get banking services only from banks. Reality is that Merrill Lynch offers checking accounts called CMA's, but the fiction is that banks only offer checking accounts. The reality is that Americans can get a credit card from commercial firms, get a mortgage from an automobile company, insure their life, their home and car from a retailer, borrow money for their business from a maker of jet engines, buy stocks and bonds from a travel agency, and fulfill all their financial needs without ever going through a door with the sign "Bank" over it.

The companies offering consumers and businesses each of these financial services and many more are listed in the phone books of America. In Middle America, in a representative city, Milwaukee, WI, the phone book lists over 50 places for its citizens in Milwaukee to buy financial services and only 4 of them are major banks.

Six, the idea that an American bank's monopoly position in cities or regions is protected by U.S. Federal banking laws and regulation is also a shadow and not reality. The Japanese today are doing to American banking what they have done to the American car manufacturers, but for a different reason.

The Comptroller of the Currency reported last October:

> The largest banking company in the world is Japanese. Four of the 5 largest banking companies in the world are Japanese. Seven of the 10—and 14 of the 25 largest banking concerns in the world are Japanese.
>
> Only 6 years ago, in 1980, none of the Japanese banks were among the largest 5 and only one of the largest ten was Japanese. The Japanese banks are not alone in global presence. Of the ten largest banks in the world, two are French. Of the largest 25, nine are European.

Seven, the view from the Federal Reserve Board on products that can be offered by banks bears the same relationship to reality as does the Federal ban on interstate banking. Once again, the Federal system has operated and the States have taken over. Currently there are 5 States of the Union which allow State-chartered banks to underwrite insurance beyond credit life. There are 8 States that sanction securities underwriting. There are 11 States that favor equity investment, and 22 States permit real estate development.

ONE-STOP FINANCIAL SHOPPING

The reality is that there is one-stop financial shopping at banks in some States, but not in others. Wisconsin banks can and do offer securities and insurance brokerage as well as banking services. There is also one-stop financial shopping in all 50 States at a Sears store or an American Express office.

Eight, Federal banking statutes now on the books were designed to protect the safety and soundness of the American banking system as it existed at the time they were passed. To a certain extent, those old statutes now contribute to the danger to the banking system. Anything that prevents the implementation of the first rule of sound banking, the wide diversification of risk, contributes a potential hazard to the situation.

It follows from this that if we are really interested in the stability of the banking system, rather than in preserving monopoly, we must find ways for banks to deliver new products to new customers in order to maintain a spread of risk in a business that is rapidly losing both our products and our customers.

Recently the Comptroller of the Currency stated that:

> Restrictions on allowable activities have prevented U.S. banks from effectively serving changing customer needs, while other financial competitors have made significant inroads into some of the best banking market segments.

He went on to say that:

> Efforts should be directed at how to structure the new activities so as to allow flexibility and still protect the bank—not at delineating what activities should be permitted. I think we will find that there are few, if any, activities that cannot safely be combined with banking.

Nine, there is a myth that small town citizens are best served by small town enterprises which are locally owned. Today the reality is that these townspeople rely on Exxon or Gulf or some international oil company for their gasoline and heating oil; they rely on some distant public utility for electricity to light their home and their barn; they rely on J.C. Penney and Sears for much of their shopping; they rely on the A&P and other food chains for sustenance; and they rely on some company like Citicorp or GMAC to supply mortgage money; and they rely on AT&T long lines to talk to their relatives.

This is not to say there are not local entrepreneurs. There are, including banks. Unfortunately, the myth of local banks taking care of local business is not so. In 1985, small banks had only 58 percent of their interest-earning assets in loans. The Federal funds market was a big part of their business, that is selling local deposits to banks in big cities.

In fact, only 18 percent of the total assets of small manufacturing are supplied by bank loans. It seems that more and more small businesses are reading ads like this one from Merrill Lynch which ran this week:

> If you could solve all your financial needs in one place, you could spend less time running from bankers to brokers to insurance agents and more time running your business. That's why Merrill Lynch offers business financial services. So that your local Merrill Lynch Financial Consultant can research your needs and provide innovative solutions.

In our pluralistic society, there is a place for all, but as in politics where the voter decides, in business the consumer decides. Federal statutes should be broadened to let American banks compete for this business.

Thank you.

[The complete prepared statement of Walter B. Wriston follows:]

STATEMENT OF WALTER B. WRISTON
BEFORE THE COMMITTEE ON BANKING,
HOUSING, AND URBAN AFFAIRS OF THE
UNITED STATES SENATE, WASHINGTON, D.C.
JUNE 18, 1987

In thinking about any problem, the first thing is to try to separate shadow from reality, lest one attempt to solve the wrong problem. In political terms, the best illustration of this state of affairs is the Electoral College. Everyone knows that the President is elected by the delegates chosen for the Electoral College, but the reality is that we all learn the name of our next President from the evening news broadcast weeks before the Electoral College even meets. The federal legal framework is untouched and functioning, but the reality of the political marketplace has overtaken it.

The financial service business is also subject to this same shadow and reality phenomenon. Federal laws and regulations are in place which might lead one to one conclusion, while the reality of the market is something quite different. There are a lot of commonly articulated positions which have little basis in today's world. Examples abound.

1) On all sides, one can hear that there is a traditional, long standing legal separation of commerce from finance in America, but that is the shadow and not the reality. The debates about this unreal shadow world do not affect our daily lives. In the real world companies selling merchandise, building airplanes, drilling for oil in the North Seas, making cars and trucks--all clearly lines of commerce--own and are in the financial service business in a very big way.

The federal law in this respect is a one-way street--banks as institutions cannot engage in commerce, but commerce can engage in financial services. In the real world, however, banking and commerce have never been separate in American history. Since the eighteenth century banking and commerce have been united in law and in practice, directly or indirectly through affiliation on a personal or corporate basis. Whatever restrictions have been placed on banks as institutions, owners of banks have always engaged in all types of businesses.

Wells Fargo & Co. combined banking with the stagecoach business--indeed California law at that time practically required banking to be united with commercial firms. On a personal level, Joe Allbritton today owns control of and is CEO of Riggs National Bank, and he also owns five television stations. In New York City, a company chartered in 1799 to supply water to the City of New York, formed and owned the forerunner of Chase Manhattan Bank. The list is almost endless.

The further reality is that no one has ever articulated an agreed-upon definition of banking or of commerce. Indeed, the Supreme Court ruled that banking itself is commerce as recently as 1985.[1] On the other hand, so far as I know, there is no unique definition of commerce. It is hard to argue that it is injurious to the health of banks to own some company engaged in a line of commerce, but good for a maker of steel or automobiles to own a financial service business.

The reality is that most of us do not know who owns our friendly neighborhood lender, nor do we care as long as our needs are met. If GMAC offers the consumer 3.9% interest rate on a car loan, and our local commercial banker quotes 9%, the fact that General Motors is making the loan and not our local banker does not really enter into the consumer's decision.

2) Another issue of shadow and reality is the question of interstate banking. For years this issue has divided the industry and the politicians. It is no longer an issue even though one hears echoes of the old rhetoric in hotel ballrooms throughout the land. The facts are that the states have taken over and solved the problem, because Congress would not address the issue.

Of the 50 states in the Union, 44 and the District of Columbia currently offer some kind of reciprocal banking privileges to out-of-state American banks, ranging in terms from total freedom of entry today, to freedom of entry at some date certain in the future, to entry only with defined limited powers.

In the real world, then, the federal system of government worked, and the problem is all but solved by the action of individual states. In short, the 9th and 10th amendments to the Constitution are in full force and effect.

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[1] Northeast Bancorp, Inc. vs Board of Governors of the Federal Reserve System, 105 S. Ct. 2545, 2553-54 (1985)

3) Another issue of shadow and reality is the so-called non-bank bank. As we have all learned by now, the non-bank bank is a non-issue issue. The institutions are performing a valid function in our economy and never did pose any threat to anything, except possibly some entrenched monopoly.

4) Another shadow issue is that the American market for financial services is separate from the rest of the world. The reality is that the American market, large as it is, is just one part of the global marketplace, and capital flows overwhelm trade. It is a matter of complete indifference to a major corporation whether it raises money, either debt or equity, in New York or London or Tokyo. All the corporate consumer wants is the best deal available in the marketplace. To think one can isolate U.S. financial institutions from the rest of the world is nostalgia, not reality.

5) The rhetoric is that one can get banking services only from banks. Reality is that Merrill Lynch offers checking accounts called CMAs, but the fiction is that only banks offer checking accounts. The reality is that Americans can get a credit card from commercial firms, get a mortgage from an automobile company, insure their life, house and car from a retailer, borrow money for their business from a maker of jet engines, buy stocks and bonds from a travel agency, and fulfill all their financial needs without ever going through a door with the sign "Bank" over it.

The companies offering consumers and businesses each of these financial services and many more, are listed in the phone books of America. In Middle America, in a representative city, Milwaukee, Wisconsin, the phone book lists over 50 places for its citizens to buy financial services and only 4 are major banks.

6) The idea that an American bank's monopoly position in cities or regions is protected by U.S. federal banking laws and regulation is also shadow and not reality. The Japanese are doing to American banking what they have done to American car manufacturers, but not for the same reason.

The Comptroller of the Currency reported in October last year that "The largest banking company in the world is Japanese. Four of the five largest banking companies in the

world are Japanese. Seven of the 10--and 14 of the 25--largest banking concerns in the world are Japanese.

"Only six years ago, in 1980, none of the Japanese banks were among the largest five--and only one of the largest 10 was Japanese. The Japanese banks are not alone in global presence. Of the 10 largest banks in the world, two are French. Of the largest 25, nine are European."

7) The view from the Federal Reserve Board on products that can be offered by banks bears the same relationship to reality as does the federal ban on interstate banking. Once again, the federal system has operated and the states have taken over: currently five states allow state chartered banks to underwrite insurance beyond credit life, eight states sanction securities underwriting, eleven states favor equity investment, and twenty-two permit real estate development.[2]

The reality is that there is one-stop financial shopping at banks in some states, but not in others. Wisconsin banks can and do offer securities and insurance brokerage as well as banking services. There is also one-stop financial shopping in all fifty states at a Sears store or an American Express office.

8) Federal banking statutes now on the books were designed to protect the safety and soundness of the American banking system as it existed at the time they were passed. To a certain extent, the old statutes now contribute to the danger to the banking system. Anything that prevents the implementation of the first rule of sound banking, the wide diversification of risk, contributes a potential hazard to the system.

It follows from this, that if we are really interested in the stability of the banking system rather than preserving monopoly, we must find ways for banks to deliver new products to new customers in order to maintain a spread of risk in a business that is rapidly losing traditional products and customers.

Recently the Comptroller of the Currency, Mr. Clarke, stated the problem with great clarity: "Restrictions on allowable activities," he said, "have prevented U.S. Banks

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[2] American Banker, 6 May 1987, quoting a report by Victor L. Saulsbury of the FDIC.

from effectively serving changing customer needs, while other financial competitors have made significant inroads into some of the best banking market segments." He went on to say that "efforts should be directed at how to structure the new activities so as to allow flexibility and still protect the bank--not at delineating which activities should be permitted. I think we will find that there are few, if any, activities that cannot safely be combined with banking."

9) There is a myth that small town citizens are best served by small town enterprises which are locally owned. Today's reality is that these townspeople rely on Exxon, on Gulf or some international oil company for their gasoline and heating oil; they rely on some distant public utility for electricity to light their homes and barns; they rely on J.C. Penney and Sears for much of their shopping; they rely on A&P and other food chains for sustenance; they rely on some company like Citicorp or GMAC to supply mortgage money; they rely on AT&T long lines to talk to relatives in distant places.

This is not to say there are not local entrepreneurs--there are, including banks. Unfortunately for the myth of local banks taking care of local business, the facts are: In 1985 small banks had only 58% of their interest-earning assets in loans. The federal funds market was a big part of their business--selling local deposits to banks in big cities.

In fact, only 18% of the total assets of small manufacturers are supplied by bank loans.[3] It seems that more and more small businesses are reading ads like this one from Merrill Lynch which tell them: "If you could solve all your financial needs in one place, you could spend less time running from bankers to brokers to insurance agents and more time running your business. That's why Merrill Lynch offers business financial services. So that your local Merrill Lynch Financial Consultant can research your needs and provide innovative solutions."

In our pluralistic society, there is a place for all, but as in politics, where the voter decides, in business the consumer decides. Federal statues should be broadened to let American banks compete for the business.

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[3] See table appendix 1.

Appendix 1

How Manufacturing Firms
with Assets Under $5 million Are Financed

	1984	1985	1986
Debt ($ billions)	52.9	53.0	53.1
Bank Credit	21.7	21.5	21.9
Trade Credit	17.8	17.7	18.5
Other Short-term	1.8	1.9	1.7
Other Long-term	11.6	11.9	11.0
Equity ($ billions)	52.3	52.1	54.4
Total Assets ($ billions)	118.1	116.6	120.0
Share of total Assets funded by Bank credit (percent)	18.4%	18.4%	18.3%

Source: U.S. Commerce Department, Bureau of the Census, *Quarterly Financial Report for Manufacturing, Mining and Trade Corporations*, Fourth Quarter 1985 and 1986.

The CHAIRMAN. Thank you, Mr. Wriston.
Mr. Weinberg.

STATEMENT OF JOHN WEINBERG, SENIOR PARTNER, GOLDMAN, SACHS & COMPANY, NEW YORK, NY

Mr. WEINBERG. Thank you very much.

The invitation to appear before this committee is very much appreciated. My acceptance was given somewhat reluctantly because, frankly, I do not have a lot of answers. Indeed, I, like you, have many questions.

PRESSURES FOR DEREGULATION AROUND THE WORLD

Change is racing through our financial markets. The global market is growing in power and volatility. There are pressures for deregulation building around the world. At home, we have largely created through "legislation by loophole" more than our share of anomalies and inconsistencies. Working under current law, the market cannot fashion a solution, nor should it. The public has an overriding interest in the outcome. And it is up to Congress, in my judgment, to study the problem as carefully as it can and to produce a legislative program. This is why I strongly support the moratorium initiated by this committee.

After 37 years of working for an investment banking firm, I do have some comments. The Glass-Steagall Act has served the country very well for over 50 years. Our capital-raising mechanism and the depth and breadth of our capital markets are the envy of the world. As proof, many countries are trying to duplicate our marketplace in many ways.

However, there can be little disagreement that this structure is falling apart because of the above-mentioned forces and the exploitation of loopholes in the law.

For example, when Japan's Sumitomo Bank wished to make a passive, noncontrolling investment in Goldman, Sachs, all of us worked carefully with the Federal Reserve Board to fashion a solution which was fully in keeping with the spirit of Glass-Steagall and the Bank Holding Company Act. Yet only a few months later the Federal Reserve granted underwriting powers directly to 100 percent owned and actively operated subsidiaries of American bank holding companies courtesy of a newly discovered loophole in the Glass-Steagall Act. In addition, the Comptroller of the Currency seems to be in the process of opening a new loophole to permit bank subsidiaries to underwrite asset-backed securities. This is no way, in my judgment, to make policy.

To me, the banks have a special role to play. They have a critical central place in our economy. I think the Government is right to support them. When banks are urged by the Government to lend to developing countries, that action should be taken into account. For example, I think that Congress frankly went in the wrong direction in last year's tax bill by limiting loan loss reserve deductions for banks.

I believe investment banks also have a special role. We are the risk-takers, the capital-raisers. Ours is a volatile, cyclical industry. While we certainly have been prosperous in the last few years, things were a lot different in the mid-70's if you will remember. There were layoffs, consolidations and failures sweeping Wall Street. There were 200 firms that went out of business. The industry lost money overall. If you read today's newspaper, however, you will see some firms are taking lickings now in the markets and I think that is indicative of the fact that trading markets are those in which you do earn money and you do lose money. We are prepared to take risks and we recognize that we are a cyclical business. We also recognize that the Government does not have to come in when there are emergencies to keep any of our firms in business and they shouldn't.

Our markets have become global. There is global banking and global investment banking. London and Tokyo have developed rules similar to ours in some ways and different in others, based on their traditions and history. Those marketplaces are all different. Our economy has evolved differently from those of other countries in many ways. For example, Federal deposit insurance, access to the Federal Reserve window, protective regulators and Federal safety nets have built a strong commercial banking industry in this country. On the other hand, American investment banking grew up with a different structure—full disclosure, demanding accounting rules, no Federal safety net, and a policeman-style regulator, which is required and necessary and I think we all agree on that. The result is an open, solid capital market that has earned the world's confidence.

Is our economy large enough and sufficiently different to merit special consideration or should all the world's financial systems be the same? Is difference even possible? What about the strong traditions and history of a country's financial system? We believe in a decentralization of economic power in this country. Can we still afford 10,000 banks and 500 securities firms? I would like to think so, but I have to say frankly I don't know.

If Congress elects to break down the barriers between commercial and investment banking and let our friends, the commercial banks, do everything—and I know they would like to do everything we do—what will that mean for concentration? What will that mean for competition? And what will that mean for the measurement and carry of risk?

Since the founding of our country, the American people have questioned the wisdom of allowing the financial systems to be dominated by a few large financial giants. With the barriers gone, I don't have any doubt that there will be a lot fewer players in the long run. It has been a good thing that financial power has been split between two industries.

I also happen to think that the existence of a separate securities industry has been good for the consumer as an alternative to the banks. It has permitted a different way to get things done. Money market funds were good for the consumer. Commercial paper was good for the blue chip corporation. Without a separate securities industry, would these alternatives have developed to the role they have today?

Even though it may sound like heresy to say so, many of our friends in banking are doing just fine. I am not one of those who believe that well-managed banks cannot do well because for our best international and regional banks returns on equity exceed that of some of our most successful corporations.

Banks are already very strong competitors in providing alternatives to our services. They are in much of our business already. If they are allowed to enter our business to a greater degree, they will be much more than very strong competitors. The last legislative proposal I saw for giving securities powers to banking organizations would have let them into about 90 percent of our securities business. With their multiple relationships and credit power, they can tie products and services together like no other industry.

How are commercial banks going to get the capital needed for the increasingly capital-intensive investment banking business? Will their core activities suffer?

The U.S. Treasury—i.e., the American taxpayer—really provides a backstop for the commercial banking industry. Government is there to rescue at least the largest of our commercial banks when failure threatens. Should Government back the increased risks of new and expanded investment banking activities if the Glass-Steagall Act is swept aside? And I think we all would agree if you look at what's going on in the markets today, there are definitely risks in many of the areas to which the banks would like to gain access. But that's the way it is. Whenever you're in a trading business, it is just that—risky.

There are only a few ways to go. We could, of course, conclude that both the Glass-Steagall and Bank Holding Company Acts have done their job for the country and are consistent with our history and tradition. If we go the route of the universal bank with an unregulated holding company owning a bank holding company, a securities firm, an insurance company, an automobile or retail company, at least everybody then can do everything. This is far removed from the history and traditions and the regulatory apparatuses to supervise second-tier activities of these organizations where regulation is truly needed will be formidable indeed.

ABOLISH THE GLASS-STEGALL ACT?

If we follow the near-universal bank suggestion—abolish Glass-Steagall while keeping the separation between banking and commerce intact—all securities firms would probably be forced to become bank holding companies or to want to own a bank holding company. Competing against the banks' tying powers and credit strength when it is competing with us across the entire business line would be a tough, if not losing, proposition. After all, we look to the banks for credit facilities every day.

We certainly think that the most difficult course for our industry, the securities industry, and the one lacking completely in fairness, is just to give the banks the securities powers they want. If banks are allowed wholesale into our business, what would be required for the securities industry to remain competitive? Should we have access to the Fed window, the payment system, or be allowed to offer insured deposits? I don't know.

In all of this, I believe—and this I think is fairly important—we must keep in mind what the impact will be on our capital-raising mechanisms and capital markets. I hope that with all this focus on what the banks want we do not lose sight of the need to keep our U.S. capital markets prosperous and strong and here in the United States. I think you would all agree, if you studied the numbers, we have already suffered some erosion to off-shore markets and we must examine why and what can be done in that regard.

None of this is easy and I have an awful lot of questions, frankly, and I do not envy Congress for the task it has before it—and I really sincerely mean that. However, I think it has a unique opportunity in this moratorium. It can, of course, just hold a few days of hearings and then file the same old bills, but I believe you will do something more than that. I think people are ready for a creative solution.

Putting Glass-Steagall back in shape is certainly one way to go. But the threshold question really is, how does Congress proceed to get the kind of answers which are needed?

In my judgment, there needs to be a process so all of the conflicting, confusing and complex information can be sorted out and digested. Perhaps, as a suggestion, Congress ought to establish its own joint committee or legislative commission with its own dedicated experts to deal with these questions. It should call upon the concerned industries, academic and others to provide participants in the process. Congress may not have the opportunity for another 50 years to do what it now has the chance to do. Maybe there is a way for the relevant House and Senate committees to work together in common cause.

I will close with this one thought. Our industry is really a product of Congress. We were created by the Glass-Steagall Act and regulated by the Securities Acts of 1933 and 1934. This is I think important. We recognize we may not be completely happy with ther results of this congressional deliberation. It's a risk obviously, but it's got to be done. But it is essential that we get the guidance from representatives of the people—namely, you all—and that is the important thing. We just hope that Congress will approach this very complicated task with the best possible tools to do the job.

Thank you, Mr. Chairman.

[The complete prepared statement of John L. Weinberg follows:]

STATEMENT OF JOHN L. WEINBERG

SENIOR PARTNER AND

CHAIRMAN OF THE MANAGEMENT COMMITTEE

GOLDMAN, SACHS & CO.

BEFORE THE

SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS

JUNE 18, 1987

My name is John Weinberg. I am the Senior Partner and Chairman of the Management Committee of Goldman, Sachs & Co., an investment banking firm headquartered in New York City with operations in various other cities in the U.S. and overseas.

The invitation to appear before this committee is very much appreciated. My acceptance was given somewhat reluctantly because, frankly, I do not have a lot of answers. Indeed, I, like you, have many questions.

Change is racing through our financial markets. The global market is growing in power and volatility. There are pressures for deregulation building around the world. At home, we have largely created through "legislation by loophole" more than our share of anomalies and inconsistencies. Working under current law, the market cannot fashion a solution, nor should it. The public has an overriding interest in the outcome. And it is up to Congress to study the problem as carefully as it can and to produce a legislative program. This is why I strongly support the moratorium initiated by this committee.

After 37 years of working for an investment banking firm, I do have some comments. The Glass-Steagall Act has served the country very well for over 50 years. Our capital-raising mechanism and the depth and breadth of our capital markets are the envy of the world.

However, there can be little disagreement that this structure is falling apart because of the above-mentioned forces and exploitation of loopholes in the law. Proceeding by regulator-fashioned loopholes creates inconsistencies.

When Japan's Sumitomo Bank wished to make a passive, non-controlling investment in Goldman Sachs, all of us worked carefully with the Federal Reserve Board to fashion a solution which was fully in keeping with the spirit of Glass-Steagall and the Bank Holding Company Act. Yet only a few weeks later the Federal Reserve granted underwriting powers directly to 100%-owned and actively operated subsidiaries of American bank holding companies courtesy of a newly discovered loophole in the Glass-Steagall Act. In addition, the Comptroller of the Currency seems to be in the process of opening a new loophole to permit bank subsidiaries to underwrite asset-backed securities. I do not have all the facts yet, so I am not completely certain about this situation. I do believe, however, that this is no way to make policy.

To me, banks have a special role to play; they have a critical central place in our economy. I think the government is right to support them. Federally insured deposits are a critical element in the banking structure -- a bedrock of confidence for consumers as well as a source of low-cost funding for banks. When banks are urged by the government to lend to developing countries, that action should be taken into account. For example, I think that Congress went in the wrong direction in last year's tax bill by limiting loan loss reserve deductions for banks.

I believe investment banks also have a special role. We are the risk-takers, the capital-raisers. Ours is a volatile, cyclical industry. While we certainly have been prosperous in the last few years, things were a lot different in the mid-70's with layoffs, consolidations and failures sweeping the Street. The industry lost money overall. There are some ominous signs currently that also cause us concern. When our industry's firms get into financial difficulty, the government does not have to come in to keep us in business. Several hundred securities firms, in fact, went out of business or were forced to merge during the mid-70s. And I am not here to suggest or recommend that the government should in any way be obligated to rescue our industry's companies.

Our markets have become global -- there is global banking and global investment banking. London and Tokyo have developed rules similar to ours in some ways and different in other ways based on their traditions and history. Our economy has evolved differently from those of other countries in many ways. For example, federal deposit insurance, access to the Federal Reserve window, protective regulators and federal safety nets have built a strong commercial banking industry in this country. On the other hand, American investment banking grew up with full disclosure, demanding accounting rules, no federal safety net and a policeman-style regulator; the result is a wide-open and solid capital market that has earned the world's confidence.

Is our economy large enough and sufficiently different to merit special corsideration or should all the world's financial systems be the same? Is difference even possible? What about the strong traditions and history of a country's financial system? We have believed in a decentralization of economic power in this country. Can we still afford 10,000 banks and 500 securities firms? I would like to think so, but I do not know.

If Congress elects to break down the barriers between commercial and investment banking and let our friends, the commercial banks, do everything -- and I know they want to do everything we do -- what will that mean for concentration? What will that mean for competition? And what will that mean for risk? This concerns me.

I note that Professor Lawrence R. Klein of the University of Pennsylvania, the winner of the Nobel Prize for Economics, seems to be worrying, too. The other day he told a conference that "bankers should concentrate on being truly good bankers." He asked, "Is it not better to let bankers be bankers, security traders be security traders, insurers be insurers, and investors be investors?"

Since the founding of our country, the American people have questioned the wisdom of allowing the financial systems to be dominated by a few large financial giants. With the barriers gone, I don't have any doubt that there will be a lot fewer players in the long run. It has been a good thing that financial power has been split between two industries.

I also happen to think that the existence of a separate securities industry has been good for the consumer as an alternative to the banks. It has permitted a different way to get things done. Money market funds were good for the consumer. Commercial paper was good for the blue chip customer. Without a separate securities industry, would these alternatives have developed?

I know the banks want to do what we do. Even though it may sound like heresy to say so, many of our friends in banking are doing fine. Obviously, there are problems with international, energy and agricultural loans, but I do not personally think that abandonment of those sectors for potentially greener fields is the answer. Banks are government-supported to play these tough roles. Their job is different from ours; they are regulated differently. Their risks are different; their support mechanisms are there to support those risks. I am not one of those who believes well-managed banks cannot do well. For our best international and regional banks, returns on equity exceed that of some of our most successful corporations.

Banks are already very strong competitors in providing alternatives to the services we offer. If they are allowed to enter our business to a greater degree, they will be much more than very strong competitors. The last legislative proposal I saw for giving securities powers to banking organizations would have let them into 90% of our business. With their multiple relationships and credit power, they can tie products and services together like no other industry. Letters of credit and co-managing housing revenue put bonds are just an example of this. Another more current one is becoming co-manager of asset-backed sales: a result achieved because of the market power of the bank involved.

How are commercial banks going to get the capital needed for the capital-intensive investment banking business? Will their core activities suffer?

The U.S. Treasury, i.e., the American taxpayer, really provides a backstop for the commercial banking industry. It stands behind the FDIC and FSLIC deposit insurance funds. The government is there to rescue at least the largest of our commercial banks when failure threatens. Who will back the increased risks of new and expanded investment banking activities if the Glass-Steagall Act is swept aside?

Universal banking or superbanks? Near-universal banks? I remain to be convinced that this is good for what we want in America. Will there then ever be such a thing as the objective lender and supplier of credit that a commercial bank is supposed to be?

There are only a few ways to go. We can of course conclude that Glass-Steagall has done a great job for this country and is consistent with our history and traditions. Perhaps all that it needs is some updating to protect it from the creative lawyers and regulators, and then it can continue to serve us for another half-century.

If we go the route of the universal bank with an unregulated holding company owning a bank holding company, a securities firm, an insurance company and an automobile or retail company, at least everybody can then do everything. This is far removed from our history and traditions. And the regulatory apparatuses to supervise second-tier activities where regulation is truly needed will be very formidable indeed.

If we follow the near-universal bank suggestion, where does that leave major industrial and commercial companies which presently have nonbank banks as subsidiaries? To abolish Glass-Steagall while keeping the separation between banking and commerce intact would probably force all securities firms to become bank holding companies or to want to own a bank holding company. Competing against a bank's tying powers and credit strength when it is competing with us across our entire business line would be a tough, if not, losing proposition. After all, we look to them for credit facilities every day.

We certainly think that the most difficult course for our industry, and the one lacking completely in fairness, is just to give banks the securities powers they want. The market clout of the commercial banks fully involved in the securities business would be too much. If banks are allowed wholesale into our business, what will we require to remain competitive? Should we have access to the Fed window, the payments system, or be allowed to offer insured deposits? Should commercial banks be required to put their insured deposits into government securities for safety and neutralization of competitive advantage? Must we become banks?

In all of this we must keep in mind what the impact will be on our capital-raising mechanisms and capital markets. Much of the debate has been about what is good for banking. I hope that with all this focus on what the banks want, we do not lose sight of the need to keep our United States capital markets prosperous and strong, accessible to all, and free of the domination of a few. We have already suffered some erosion to off-shore markets and we must examine why and what should be done in that regard.

I just have an awful lot of questions. I do not envy Congress the task it has before it. However, I think that it has a unique opportunity with this moratorium. It can of course hold a few days of hearings and then file the same old bills. But I believe it will do more than that. A creative solution has to be found. Putting Glass-Steagall back in shape is certainly one way to go. A key threshold question is how does Congress proceed to get the kind of answers which are needed? We have all heard the rhetoric of the parties and their paid consultants. Now it is time to address the fundamental question, "What is best for this country in this day and age?"

In my judgment, there needs to be a process so all of the conflicting, confusing and complex information can be sorted out and digested. Perhaps

Congress ought to establish its own joint committee or legislative commission with its own dedicated experts to deal with these questions. It should call upon the concerned industries, academics and others to provide participants in the process. Congress may not have the opportunity for another 50 years to do what it now has the chance to do. Maybe there is a way for the relevant House and Senate committees to work together in common cause. Congress has to make the rules, we will follow them.

Our industry is really a product of Congress, created by the Glass-Steagall Act and regulated by the Securities Acts of 1933 and 1934. We recognize that we may not be completely happy with the results of congressional deliberation, but it is essential that we get guidance from the representatives of the people. That is the most important thing. We just hope that Congress will approach this very complicated matter with the best possible tools to do the job.

Thank you for your attention.

The CHAIRMAN. Thank you very much, Mr. Weinberg.

I want to congratulate each of you witnesses. I think this has been very, very helpful, partly because you disagree so strongly. You have given us a number of options, and you have challenged us to work hard to come up with a rational, fair, and relatively safe system. I think you make it clear why it's going to be so difficult for us to act and why, indeed, as it was pointed out by Senator Armstrong and others, that we've gone through this for a long, long time and haven't been able to be successful in acting in the past.

There will be a 5-minute rule on questioning.

Mr. Corrigan, the FDIC reports that over 20 States have authorized their State-chartered banks to engage in a wide variety of activities, including in some instances insurance and securities underwriting and brokerage, real estate development, and direct ownership of commercial companies. At present, State-chartered banks that are subsidiaries of a holding company may be reluctant to exercise such powers because of the Federal Reserve interpreting the activity limitations in the Bank Holding Company Act as applying to State-chartered subsidiary banks.

If the Federal Reserve under a new Chairman were to reverse this position, what would be the implications for passage of Federal powers legislation?

Mr. CORRIGAN. Well, let me first, if I may, Mr. Chairman, suggest that the situation that you point to with regard to the States is one of a long list of anomalies that could be pointed to domestically and internationally that bear on the need for reform.

To be sure, the dual banking system has served us well, but even there, there's a point where you have to ask yourself how do you reconcile unlimited activities for banks at the State level, with the presence of a Federal deposit insurance system, of a Federal Reserve System, of a Federal lender of last resort? There is, I think, at some point a conflict here and I don't think you're going to solve that conflict in a fundamental way, if I may say, with a new Chairman of the Federal Reserve. The problem will not go away. It's going to have to be dealt with in a more fundamental way by legislation.

The CHAIRMAN. What soundness risks would there be in the rapid breakdown of the banking-commerce separation through exploitation of State-authorized powers? You spoke on that and you spoke with some force.

Mr. CORRIGAN. Well, again, I feel very strongly on this point. I have in my testimony laid out I think a fairly coherent argument in terms of why it matters. In the interest of time, I would simply make 2 observations right now. Maybe these, Walter, will fit in the realm of shadows and realities, too.

One is, as I look around the world, I do not see in any of the major industrialized countries patterns whereby major banking organizations are owned and controlled by commercial companies.

To be sure, in some countries such as Germany, the banks have more freedom to own shares in commercial companies, but not the other way around.

Indeed, I think the only truly contemporary 20th century example of a broad-based systematic blending of banking and commerce that we know of was the Zaibatsu system in Japan in the 1930's in particular.

I would suggest, Mr. Chairman, on the way down on the plane I was reading part of a history of that Japanese system that was written by Professor Schumpeter in 1940 and it explains and lays out in some detail the way the system worked and the abuses that grew out of it. And if that's what we want, fine; but that's what we will get.

THREAT TO THE FDIC

The CHAIRMAN. Is there a threat to the Federal Deposit Insurance Corporation similar to the one FSLIC is suffering now from State-authorized direct investment programs?

Mr. CORRIGAN. There is no threat at the moment, but I think, again, the logic of it is that such a threat could emerge, but I certainly see no such threat now.

If you take the long view, then you clearly could envision circumstances in which that might happen.

The CHAIRMAN. Mr. Wriston, your remarks were delightful. You reminded me of the opening pages of Plato's Republic when you talked about shadow and reality, with the fire in the background and facing the shadows and confusing the two. It was very convincing.

However, you didn't specify any agenda for this committee. My impression is that you like reality, and I gather that you don't think the committee should do anything particularly; that it doesn't have to. The reality has taken care of the situation. Is that unfair?

Mr. WRISTON. No, Mr. Chairman. What I was attempting to say is that the marketplace is overtaking the work of this committee. Several Senators have remarked on the fact that a decade has passed without the passage of a major reform bill and the world out there won't wait.

All I was attempting to say was that Jerry talks about separating commerce and finance, but if you're a little bank trying to make automobile loans and GMAC, which last year made more money than any commercial bank in the United States and a leading originator of residential mortgages in the United States, comes into your town, it's sort of a ridiculous argument as to whether commerce is an industry when General Motors is out there. Such firms insured net new automobile loans last year by 30%; at commercial banks, such credits dropped 15%.

[The following was subsequently submitted for the record:]

WALTER B WRISTON
CITICORP CENTER
153 EAST 53 STREET
NEW YORK N Y 10043

[illegible] -3 [illegible]

SUITE 4000

July 6, 1987

The Honorable William Proxmire
United States Senate
SD-531 Dirksen Senate Office Building
Washington, D. C. 20510

Dear Bill:

In the course of reviewing my answers to the questions posed by members of the Senate Banking Committee following my testimony on June 18, I find that I mistakenly named General Motors Acceptance Corporation the leading, rather than a leading, originator of residential mortgages in the United States. In fact, Citicorp is currently in first place.

But what I really want to emphasize is not where GMAC or Ford Motor Credit stands today in relation to banks or to the traditional mortgage makers, the thrifts. The point is that firms that are not banks, but nevertheless compete directly with banks, operate with a truly awesome competitive advantage. Such firms have the flexibility to provide virtually whatever package of products and services their customers demand and therefore have the incentive to tap virtually any market that they find attractive. Thus, GMAC, which entered the mortgage market only a short time ago, is already a major originator of residential mortgages and a leading mortgage service firm.

Hamstrung by an archaic legislative and regulatory system, a bank holding company cannot simply decide on the optimal business strategy and follow it. Consequently bank holding companies cannot serve their customers as, how and where those customers wish to be served. This is not good for banks and, as there is less competition in the marketplace, it is not good for the public they serve.

To put the record straight and to keep me in good standing with my former colleagues, I would very much appreciate your inserting this letter into the hearing record.

Again, I want to thank you for the opportunity to appear before your committee, and I would welcome the opportunity to continue the dialogue.

Sincerely yours,

Mr. **Wriston**. The same thing has happened in the commercial paper market. The only comparative advantage that a bank has is—and you don't survive without a comparative advantage—information. In today's information society, the treasurer of General Electric knows just as much about the credit of General Motors as a bank does, and the result of that is we don't have any more commercial loan business to the big companies. In recent years, firms like GE and GM more than doubled their borrowings in the commercial paper market while the commercial loans of the money center banks increased by scarcely more than 25 percent.

So we're talking about an industry that has lost a consumer business to Sears, to Mobil Oil, to J. C. Penney, you name it, and we're talking about an industry that has lost its big commercial lending in the commercial paper market and its automobile lending to Ford Credit and GMAC. So it isn't as if this were the world of 10 years ago.

That was the only point I was trying to make. What you regard as a "bank" is no longer relevant to the discussion because GMAC is a bigger bank than most of us.

The **Chairman**. Well, my time is up. Mr. Wriston, you made your point extremely well and I didn't mean to be facetious. But I think it would be helpful to us, because of your great experience and your great success in banking—we all admire and respect you—if you could give us a letter indicating what action you think the committee should take, because we're determined to take action this year.

Mr. **Wriston**. I'd be glad to.

[The following was subsequently submitted for the record:]

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July 6, 1987

The Honorable William Proxmire
Senate Committee on Banking, Housing,
and Urban Affairs
Room SD 530 Dirksen Senate Office Building
Washington, D. C. 20510-4902

Dear Chairman Proxmire:

During the hearing on June 18th, you requested that I write to you and the members of the committee regarding my thoughts on how the laws governing the U.S. financial services industry should be reformed. This letter is in response to that request.

First off, I think we have to ask why reform is needed at all. The answer, as I indicated in my testimony, is that the current system of financial regulation has not permitted firms to adapt to changing market conditions. The Bank Holding Company Act and the Glass Steagall Act prevent firms from offering their customers a full line of financial and non-financial services. Moreover, the Bank Holding Company Act forces bank holding companies to undergo elaborate application and review procedures before they can offer new services to the public. Even if the Federal Reserve does eventually approve new activities for bank holding companies, it usually attaches onerous conditions to its approval, and its approval is usually followed by a lawsuit from people with whom bank holding companies would compete. As a result, years can elapse before a firm is able to improve its service to its customers. That has undercut the competitiveness of U.S. firms in the global marketplace.

Thus, any new system of financial regulation should be flexible. Firms should be able to respond quickly to the changing demands of their customers. At the same time, the new system should fulfill the legitimate public policy aims of the old, namely, the preservation of stability in the payments system and the protection of consumers' savings.

How should these aims be accomplished? There seems to be a consensus that some form of financial services holding company is the way to go. The debate is now moving toward a discussion of how the financial services holding company should be structured.

That is all to the good. For too long, the debate has been phrased in terms of whether banks should be permitted to have broader powers. The real questions are: Who should be permitted to own a bank? In what activities should the affiliates of banks be permitted to engage? How should organizations owning a bank be supervised and regulated?

In my opinion, any corporation should be able to own a bank, and affiliates of banks should be able to engage in any lawful activity not permitted for the bank itself, provided the affiliate is a separately capitalized corporation. I do not see the merit of drawing a line between banking and commerce. Throughout U.S. history, the owners of banks have engaged in 'commercial' activities, and that remains the case today. In fact, it is quite common. In addition to non-bank banks and non-thrift thrifts, there are non-company companies -- individuals, such as Sam Walton, who own controlling interests in and manage both banks and commercial enterprises. Mr. Walton is chairman of Wal-Mart Department Stores and of Northwest Arkansas Bankshares. There is no evidence to suggest that such affiliations between banks and commercial enterprises have endangered the safety and soundness of banks. What is right for Wal-Mart should be right for Sears as well.

Parenthetically, it should be noted that the union of banking and commerce has nothing to do with the issue of concentration. Allowing banks and commercial firms to affiliate with one another will not increase market power. Indeed, competition is likely to be enhanced, if commercial firms are allowed to form bank subsidiaries, and bank holding companies are allowed to enter lines of business currently closed to them. If the affiliation of a particular bank with a particular commercial enterprise should threaten to create excessive market power, I would suggest that this is best handled on a case-by-case basis through application of the anti-trust law and/or the Change in Bank Control Act.

As you know, many individuals currently own banks and commercial firms of modest size. The reform I have proposed would allow these individuals to put their shares in such banks and commercial firms into a holding company. The issue of consolidating ownership of banking and commerce in this manner in a holding company is therefore independent of size per se.

Companies grow large, only if they have been able to serve many customers well over a long period of time. Companies remain competitive, if they can respond to the needs of their customers. If they do not, they will atrophy and die. All that I have suggested is that owners of banks be permitted to respond to the needs of their customers, just as do owners of other businesses.

To the extent customers require new services, and these are supplied by subsidiary companies, these could be subject to functional regulation. The bank would be supervised by the appropriate bank regulators; the insurance company, by the state insurance commissioners; the securities company, by the SEC; commercial companies, by the regulators applicable to that line of commerce (as, for example, the FCC regulates the TV stations owned by Joe L. Allbritton, the principal owner and chief executive of Riggs National Corporation).

I see no need for a parent company regulator. American Express Company has no such regulator, and the public is well served. Indeed, I feel it would be a mistake to introduce a parent holding company regulator to supervise financial services holding companies in the same manner as the Federal Reserve supervises bank holding companies today. Such a parent holding company regulator would very likely inhibit the ability of the organizations under its supervision to respond to the needs of their customers. In other words, such a new system would be inflexible, perhaps even more inflexible than the old.

Another important reason for refraining from introducing a parent company regulator concerns keeping the federal safety net where it belongs -- the protection of small, domestic deposits. If there is a parent company regulator, it may be tempted to rescue the institutions under its charge, and this can lead to an extension of the safety net under people whom it was never intended to catch, and so place strains on the deposit insurance funds.

Indeed, in my opinion this is exactly what happened in the case of Continental Illinois. The bank failed, but regulators resolved the failure in a manner that protected not only uninsured depositors of the bank but also creditors of parent holding company. I understand that this extension of the safety net to the parent company came at the behest of that parent company's regulator -- the Federal Reserve. Thus, if we are to avoid the expectation that losses will be socialized, (and both Gerry Corrigan and I agree losses should not be socialized), we should avoid instituting a parent company regulator.

Let me now say a word about how banks that are subsidiaries of financial services holding companies should be regulated. As I indicated above, such banks would be full service banks, regulated and supervised by appropriate federal and state bank regulators. For example, if the bank were chartered as a national bank, it would be subject to regulation primarily by the Comptroller of the Currency and secondarily by the FDIC and the Federal Reserve, just as it is now. Banks that were subsidiaries of financial services holding companies would continue to subject to all the rules and regulations currently applicable to national or state chartered banks, including limitations, such as Section 23A of the Federal Reserve Act, that restrict the transactions of the bank with its affiliates.

If Congress deems that additional protection for banks is required, I would suggest that it is far more efficient to increase the supervision of the bank itself, rather than introduce supervision over the company owning the bank. Such additional protection for the bank might take the form of increased capital requirements for the bank itself and/or a provision to allow the regulator to require the parent to recapitalize the bank or divest it, if the bank's capital falls below the minimum applicable to banks that are not subsidiaries of financial services holding companies. Such capital provisions would, together with section 23A, more than adequately insulate the bank. Such provisions focus on what needs to be protected (the safety of the bank and its deposits), and leave organizations owning banks the flexibility required to respond to the needs of their customers.

In sum, the solution that I have proposed is neither deregulation nor reregulation. It is regulatory redesign for today's financial marketplace. Its tenets are free entry and functional regulation. Any company should be able to own a bank, and a bank's separately capitalized affiliates should be able to engage in any lawful activity. There should not be a parent company regulator except the harsh discipline of the market, but each financial activity should be regulated by its appropriate regulator. In that way flexibility and safety will go hand in hand.

Sincerely,

The CHAIRMAN. Senator Armstrong.

Senator ARMSTRONG. Thank you, Mr. Chairman.

I join you in congratulating the witnesses. Like everything else, the quality of testimony presented before this committee and others varies and some of it is pretty good and some of it is pretty dreadful, to tell you the truth. And this morning's testimony, I must say, has been stimulating and it's fairly rare that anybody ever hears me say that about the testimony presented before a Senate committee.

I'd like to start, Mr. Corrigan, by inquiring just how you would respond to what Mr. Wriston has said, but others have said it on other occasions; that whatever the theoretical concerns you have about mixing commerce and finance, isn't it true that it's already happened? And I won't recite the list that Mr. Wriston has already given but I will add one item to it.

Having been approached, I thought, by every single kind of business entity in the world with offers of credit cards, I was approached recently by an airline. And that was such a novel idea that I could subscribe to a credit card and not only get credit facilities but also get mileage credits for my airline account, that finally got me and I did do so. If anyone wants to know I'll tell them afterward which airline it was and which credit card.

But the point is, isn't it true that these functions are all scrambled and how can we unscramble them?

Mr. CORRIGAN. Well, first of all, actually I think it should be stressed that I do in fact agree an awful lot with what Walter is saying. I think where we differ is in terms of what we do about it and even there I'm not sure the difference is quite as wide as one might suspect.

COMPREHENSIVE FINANCIAL REFORM PROPOSAL

Specifically, I, some months ago, put on paper a comprehensive financial reform proposal. I did it to run something up the flagpole. I am not wedded to every single detail of it, but the scheme that I have put forward tries to deal with the very problem you suggest by having basically 3 classes of institutions. It would permit GM to have GMAC and GMAC to be engaged in a wide range of nondepository insured activities—banking activities, if you will.

But by the same token, it would also permit a bank or a securities company to be involved in a wide range of activities as well.

So I do think, Senator, that it is possible to formulate a system that does an awful lot in the directions that so many have suggested, while at the same time preserving that basic distinction that I think is so important and preserving a system that is not only efficient, not only competitive, not only responsive to consumers, but also responsive to legitimate, broad-based, public policy considerations associated with safety and impartiality of the banking system.

Senator ARMSTRONG. Well, I am familiar with your earlier proposals and in fact, both publicly and privately applauded the proposal you put forward earlier this year, at least as a point of departure. But I didn't think, to tell you the truth, that the tone of your remarks this morning was entirely consistent with those proposals, if I understood them correctly.

Mr. CORRIGAN. I, unfortunately, in my statement skipped a lot of the things that would be very germane to that. My statement, as a whole, I think is fully consistent with that.

Senator ARMSTRONG. Well, I'm glad to get that on the record.

What I understood you to say in your earlier observations—and I will read your entire statement today—was that to the extent that a nonfinancial company gets into financial services, that those services should be subjected to exactly the same kind of regulation so that if somebody wants to get into the deposit business they ought to be regulated with respect to that part of their business activity along the same lines and I guess by the same regulatory authorities as anybody else who takes deposits. That wouldn't apply if they are also in the business of selling shoes and socks to that part of their business. But if they are in the deposit business, as I understood it, you were saying that they ought to be regulated according to those standards.

I think I put some words in his mouth that he's not entirely comfortable with.

Mr. CORRIGAN. I would not permit, to take an extreme case, General Motors to buy Citicorp.

Senator ARMSTRONG. But you would let them do some of the same things?

Mr. CORRIGAN. Absolutely.

Senator ARMSTRONG. I see my time has expired.

Mr. CORRIGAN. But not in the insured deposit-taking business.

Senator ARMSTRONG. The chairman has tactfully reminded me that my time is up, but I'd like to come back another time.

The CHAIRMAN. Thank you, Senator Armstrong.

Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Mr. Wriston, I'd like to direct my first question to you and then I would be interested in Mr. Corrigan's and Mr. Weinberg's comments, too.

Following up on what Senator Armstrong was alluding to, trying to separate commerce and banking now with what has gone on in the last 10 or 15 years, aren't we behind times basically? Hasn't the separation de facto occurred out there? Market forces and the efficiency of those forces have brought forth things that were unheard of back in the 1930's or 1940's or even the 1950's, and I'm wondering what the next 10 years are going to do if we remain paralyzed in this committee and in the House committee and do nothing as far as make public policy. The public policy is being made for us, as I see it, out there by market forces and they are probably the most efficient.

I would like your comments on that.

Mr. WRISTON. Senator, I agree with you entirely. The marketplace is in fact making this and it is consumer-driven. We talk about public policy——

Senator SHELBY. Isn't it always consumer-driven?

Mr. WRISTON. It should be in a nonmonopoly situation.

Senator SHELBY. Where you have no barriers?

Mr. **Wriston**. That's correct. And I would like to speak to one point that you mentioned. The American Express Co. owns the 49th largest bank in the United States. It is subject to FDIC. It is subject to the regulations. It's called the Boston Safe Deposit and Trust Co. It owns one of the largest insurance companies in the United States, the Firemen's Fund. I don't have to tell any of you don't leave home without their card. It has an enormous card base. They are underwriters of securities. They are part of Jerry's transmission belt because Shearson is a primary dealer.

AMERICAN EXPRESS HOLDING COMPANY IS UNREGULATED

And the market value of American Express exceeds that of any other financial institution in the United States and their holding company is totally unregulated. So where I differ from Jerry is that it has function regulation. The SEC regulates its securities. The State banking authorities regulate the bank and the FDIC regulates the bank. The insurance commissioners in various States regulate the insurance company. The IDS out in Minneapolis, one of the largest mutual funds in the world, is regulated by the SEC. And there is no regulation at the holding company level.

The customer is served. The market likes it or it wouldn't put that capitalization on it. So that is a model which I think serves the customer.

Senator **Shelby**. And who is being basically strangled is commerical banks because the investment bankers are either owned by some large companies or they are into everything, and the Glass-Steagall restrictions are aimed strictly at the commercial banks, are they not?

Mr. **Wriston**. That is correct.

Senator **Shelby**. Dealing in mutual funds keeps you from dealing in basic investment practices and other things.

Mr. **Wriston**. Yes, sir.

Senator **Shelby**. Mr. Corrigan?

Mr. **Corrigan**. Again, I just take it one step further and point out that as a practical matter every major U.S. bank owns an investment bank overseas. They all have merchant banks or investment banks in London or Sidney or Hong Kong or wherever.

Senator **Shelby**. And we could do it here except for Glass-Steagall?

Mr. **Corrigan**. That is correct. Again, on the American Express case, again just so there's no confusion here to you, Senator, or you, Senator, that model is completely compatible with the approach that I have suggested, except on one central point. I strongly believe that in a context especially in which the institution has a direct claim on the Federal Reserve that the Federal Reserve should have some oversight responsibility. And if we are, as a central bank, going to be in the business of extending credit through the discount window or through the payments mechanism in amounts of tens of billions of dollars a day I might add in connection with the payments system, it seems to me that any banker would say that we should do what any bank should do, and that is know our customer.

The idea that we should casually extend credit I think is quite foreign to the essence of banking itself.

Senator **Shelby**. Mr. Weinberg, do you have any comments?

Mr. **Weinberg**. Well, I do think that certainly the marketplace has moved very fast, as I mentioned in my testimony, by the various evolutions through the loopholes and finding ways to get around the laws. There is no question, though, that the banks do have an advantage over investment banking firms because they have guaranteed deposits and in certain other ways with their regulations that are different from those of the investment banking industry. I'm not saying that's wrong because basically there are differences.

In addition there is the problem of the large concentration of power.

Senator **Shelby**. My time has expired. Thank you, Mr. Chairman.

The **Chairman**. Senator Garn.

Senator **Garn**. Thank you, Mr. Chairman.

I guess I sit here with a rather large amount of frustration. As I listened to the testimony—and I agree with my colleagues that it is good testimony; but it is no different testimony than has been going on the 12 years I've sat at this table; with the positions still hardened, the unwillingness to give, the unwillingness to compromise. That's why we have no banking legislation.

SELFISHNESS AND GREED WITHIN FINANCIAL INDUSTRY

What has changed, however, as has been said by many here today, is the marketplace. It's changed so much more rapidly than I ever anticipated. A few years ago I gave speeches about the revolution in the financial services industry and people would say, "Jake, get off the end of the limb, come back in, you're too far out." They would ask me to make predictions about what the financial services industry would look like and I hesitated because my crystal ball was no better than anyone else's.

Yet if we went back and reviewed some of those speeches of a decade ago or even 5 or 6 years ago, I was wrong because my predictions for the speed of change were entirely too conservative. It changed much more rapidly than I possibly could have anticipated.

And while we continue to fight intramural battles here within the United States, the internationalization of the capital markets continues at an unbelievable pace.

Gentlemen, I would suggest to everyone listening that while we continue to play these games with inaction, it's the Japanese and the British and others who are going to win. Who has the biggest insurance companies? Who has the biggest banks? Who has the biggest securities firms? They're mostly all Japanese because they don't play the intramural games that we do here.

So I have a great deal of frustration at the unwillingness of Congress to act, but the major reason we have not acted is because of the selfishness and greed of each of the industries involved who aren't willing to give an inch. And some day they are going to come back and say, "Good heavens, we lost the ballgame overseas while we were fighting with each other."

To me there's a touch of unreality in even listening to this.

Mr. Weinberg, I certainly have a great deal of respect for you, but your testimony essentially paints a picture of a securities industry that sticks to its business, an insurance industry that sticks to its business, and a banking industry that ought to stick to its business. Well, I could agree with that a decade or two decades ago, but you can't really believe that the insurance industry and the securities industry have stuck to their business. This wouldn't even be an argument. We would still have things very nicely pigeonholed in a rolltop desk if everybody was doing their business. But there is massive, massive intrusion by retailers, whether Sears, American Express, whoever, into the traditional banking business. That is a fact. That is not an opinion.

We can argue about how we address that problem and how we try to change it, but to continue to come in and talk about safety and soundness of banks and concentration from the securities industry is an insult to this Senator's intelligence.

If the securities industry and the insurance industry really believe that, then let them get back into the insurance business and back into the securities business and then this Senator would not promote even municipal revenue bonds for a commercial bank.

But that compartmentalization just does not exist. You talk about concentrations and this fear of big banks. It's interesting that the top 5 securities firms control 96 percent of the commercial paper market—96 percent. What unbelievable concentration. Two securities firms control more than 50 percent of the municipal revenue bond or mortgage-backed securities market.

When I was mayor of Salt Lake City I used to get 2 bids or maybe 3 for my municipal securities because the banks weren't allowed to compete, and my taxpayers paid a lot more money for those bonds.

So is there any reality in the securities industry, any willingness to admit that you're not pure and that you do—maybe not Goldman, Sachs—but in the securities industry in general and in the insurance business, that these industries are at least in services that look like banking services?

Mr. **Weinberg**. Well, first of all, let me say that I don't think that you could have the Travelers Insurance Co., General Electric Co., and the Sears, Roebuck Co. be in the investment banking business—have them join our business and not believe that you're in competition. And the banks are in most of our business, anyway right now.

So we are aware of the competition and what's happening. The other thing I would say, it's interesting to note that, although the Japanese banks which are the largest banks in the world, they got that way because there is their country's Glass-Steagall Act which was copied word for word from our Glass-Steagall Act. So I think that what my friend, Walter, has been talking about is the fact that the yen has increased so rapidly and that's one of the reasons why they have become so large. But, they existed in the Glass-Steagall environment and have duplicated our law.

Senator **Garn**. You should be in politics. You diverted from my central question——

Mr. **Weinberg**. No thanks, sir.

Senator **Garn** [continuing]. About the internal competition and the changes in securities and insurance by increasing the value of the yen in Japan.

My time is up but I'll be back. [Laughter.]

Mr. **Weinberg**. Thank you.

The **Chairman**. Senator Wirth.

Senator **Wirth**. Thank you very much, Mr. Chairman. I join my colleagues in commending you for taking this one on again. I'm familiar with much of the argumentation that we've heard this morning, but maybe as a possibility of approaching this in a bit of a different way perhaps, Mr. Corrigan, you are one of the three witnesses this morning who has laid out a proposal and presumably one of the things that we are to be doing here is to try to figure out our way through this extraordinary maze of political veto power, which I think Senator Garn was suggesting is absolutely correct. It's very hard for us to do anything locked in as all of us perhaps have been, but more importantly because so many industries have been locked in out there with a lot of veto power.

So how do we do it? How do we get out of this? Maybe I could ask you to—I have 5 minutes I think. Maybe I could ask you in 1½ minutes to summarize your proposal and then I could ask Mr. Wriston in 1½ minutes to react to that and then ask Mr. Weinberg in 1½ minutes to react to that, and we might get out 1 or 2 or 3, perspectives and see if there is any possibility coming out of the panel we have this morning to start making some progress. Would that be all right, gentlemen?

Mr. **Corrigan**. In 1½ minutes, it will be tough, but I'll try.

Senator **Wirth**. Well, we live in that particular environment.

Mr. **Corrigan**. It basically contemplates 3 broad classes of corporate entities. The first is something that would look a lot like today's bank holding company except that that company could engage in a full range of financial services, but could not be owned by General Motors.

The second category would be a financial company—securities, insurance, whatever—but a company who chooses not to own or control banks. But even there, they could engage in a whole range of financial activities. That would be something like Goldman, Sachs as we know it now or Salomon Brothers as we know it now.

A third class would be the commercial nonbank financial, the GE's and the GM's. Again, the big distinction there is those companies could not own and control insured banks.

Now building on that, it then goes on to basically try to create a level playing field. There's a long, long, long list of specific changes that are recommended, everything from paying interest on demand deposits and reserves, creating liquidity reserves in the system, functional regulation—a literal panoply of things flow from that, but the essence of it starts there.

It is a system that relies very heavily on voluntarism, as I've described it. Firms can roll their own, make their own choices based on their strategic evaluation of one form of organization versus another. But it is a system that relies heavily on voluntarism.

Senator **Wirth**. Your 1½ minutes is up, Mr. Corrigan. I'm sorry. Mr. Wriston?

Mr. WRISTON. Thank you, sir. I would make one point that right now insurance companies, pension funds, mutual funds, money managers manage $2 trillion of savings. That's roughly two-thirds of the total assets of all the banks in the United States. And when you talk about where total savings go, at best one-third is in the banking system.

USE AMERICAN EXPRESS AS A MODEL

Second, I have no quarrel with Jerry's idea except in one specific thing. My model would be the American Express Co. which the consumer likes, which has an insured bank, which has an insurance company. The only difference is that the regulator of each functional thing is the Federal regulator concerned with that business. In other words, the SEC is looking at the securities part. The State banking commissions are looking at the State bank. The insurance commissions are looking at insurance. And I think that functional thing is a good idea.

But the holding company itself doesn't need the regulation. Jerry's point is that he should be a prudent lender but he's not lending to the holding company. If he lends, he lends to the bank and those records are available from the FDIC and from the State commission. So that would be my model.

Senator WIRTH. Mr. Weinberg.

Mr. WEINBERG. I must say that this is really the first time that there has been any serious dialog about leveling the playing field and giving powers to investment bankers, as Jerry is beginning to talk about in his proposal, and I think it makes some sense since we are not insensitive to the fact that there have been changes. We live in that world every minute, believe me, and we're not hiding our head in the sand either.

But I think that as long as you have equal regulation and equal powers so that you are not hamstrung from the powers that you have to build your business, I think that's a good place to start and I certainly think it would be constructive.

Again, I want to say I'm not an expert on the banking business. I haven't focused on them in detail. I'm sort of an operating guy in a company, but I certainly think it's a hell of a good place to start.

Senator WIRTH. Well, gentlemen, thank you very much.

Thank you, Mr. Chairman. Just as a quick summary, it seems to me, looking at some kind of a way in which we might functionally separate what a depository institution does to safe money and people feeling secure about that, what kind of venture capital people may do, and what insurance people may do, which goes, I think, to the base of what Mr. Corrigan is suggesting perhaps gives us a way of starting to sort this out. And I really appreciate that as a start and hope that perhaps we can find our way through these land mines of interests and so on that were suggested by Senator Garn quite eloquently that we've all been through.

Mr. Corrigan, I thank you very much. Gentlemen, thank you very much for being here this morning.

The CHAIRMAN. Thank you, Senator Wirth.

Senator Hecht.

Senator HECHT. Thank you, Mr. Chairman. I also want to compliment you on this distinguished panel. I don't know when we've had a better panel than this.

Gentlemen, the buzz word today in Washington is competitiveness and the trade bill is coming up to the Senate perhaps this week or next week for sure. We're talking about the trade deficit. As I've been traveling around as a member of the Banking Committee, there are 2 major banks in particular—I'm not going to mention their names, but many others are saying they are going to give up their charters in America and move overseas.

U.S. BANK VS. INTERNATIONAL COMPETITION

I want to ask each one of you, what is this going to do to our banking competitiveness and what is this going to do to our trade deficit because I would like to enter these remarks next week when we discuss the trade bill? Will you start off, please, Mr. Corrigan?

Mr. CORRIGAN. Well, I'm not sure of the examples you're referring to and I suspect there's a little rhetoric in there, but the basic point you're making, I think, is entirely valid and Walter touched on it earlier.

Banking markets and financial markets truly are global. National boundaries have no relevance to speak of at all any more. Money is as fungible as the air. And that, to paraphrase Mr. Wriston, that's reality. And I think it dictates—it absolutely dictates that as we try to come up with a coherent approach as to what we should do here, we've got to be sensitive to realities around the world.

I do not, however, have the deep-seated concerns that some observers seem to have that U.S. financial companies are going to be left in the dust. I don't see it that way. Quite to the contrary.

Senator RIEGLE. I'm sorry. I'm having difficulty hearing you.

Mr. CORRIGAN. I was saying I do not share the concerns that are so deeply held in some quarters that U.S. financial companies—banks or otherwise—are simply going to be left in the dust in terms of international competition.

Senator HECHT. Excuse me. That is not what they are saying. What they are saying is, they can do much better overseas as a unit overseas operating in America and be more competitive and make more money than by having their charter here in America.

Mr. CORRIGAN. That's at the very core of one of the reasons why I think that Congress must get on with the task of reform. I agree with that.

Senator HECHT. Mr. Wriston, would you care to comment on that?

Mr. WRISTON. Yes. I think two points that Jerry referred to are important. A market is no longer a geographical location. It's a blip on a screen and there are roughly 230,000 screens and more than a thousand different trading rooms in the world and they trade 24 hours a day. And the trading rules in the London market are very different from the trading rules here.

And the American commercial banks went overseas and they do underwrite in London and they don't have any problems on that. I think it is more than rhetoric, those two large banks that you spoke of, about moving their charter somewhere else if they were forced to because the competition they are up against from the big commercial firms. General Electric's annual report last year said that they are among the 10 largest lenders to American business, and they own Kidder Peabody, and they own the third largest reinsurance company in the world and they own the largest workmen's compensation insurance company—and how do you compete when every time you apply for a new power you get turned down and GE and General Motors eats your lunch?

So what you have to do—an option which you have to explore is, should the head office of a bank be somewhere else. So that while it's a difficult question, I wouldn't take it very lightly because survival is a powerful spur.

Senator **Hecht**. Mr. Weinberg?

Mr. **Weinberg**. Well, I too discussed in my talk that there has been erosion in the capital-raising mechanism in our country. There is no question about it.

The problem is, that requirements have developed over a long period of years. The accounting that we have, the SEC regulation, public offers, and full disclosure are the foundation of our capital market system. Overseas they are not as particular about those things. Today you don't just talk with clients about what you're going to sell or what instrument you will sell, a bond or a stock; you talk about what you're going to do, where it's going to take place, and what kind of regulation you're going to be under. You have the choice and this is what's happened.

Therefore, the whole world, as these gentlemen have said, has become a world marketplace and I think—the banks have figured out a lot of ways to do a lot of things, and when they figure out how to do it, they will do it.

Senator **Hecht**. Thank you. My time has expired.

The **Chairman**. Thank you, Senator Hecht.

Senator Sanford.

Senator **Sanford**. Thank you very much, Mr. Chairman.

I appreciate the testimony we have received today. It has been most helpful, and we will take your comments into consideration.

Let me ask a couple of questions that have not been directly addressed.

Mr. Wriston, my question pertains to the size of our banks, yours being one of the largest, in comparison to the giant Japanese banks. Do you think we need to promote active growth to reach that size?

Mr. **Wriston**. I think one of the interesting things, Senator, on concentration is that the American banking industry is the most fractionated industry in the world. We've talked about two firms having 50 percent of the commercial paper market, for example. The last time I looked, Citicorp had 3 percent, more or less, of the deposits in the United States. That's a lower percentage I think than any other industry that I can name.

Senator **Sanford**. Do you think you need to be as large as the Japanese banks?

Mr. **Wriston**. I think that you're going to have to raise large amounts of capital and I think you're going to have to have large resources. But most of all, you have to have the first rule of banking, which is diversity of risks.

Senator SANFORD. You have made that point very well, but do you think we need to get big in order to compete?

Mr. WRISTON. Yes. I think that it's a big world. It costs $50 million to finance one airplane these days. When I came in the business it cost $125,000 for a DC-3.

IMPOSSIBLE TO COMPETE WITH GE AND GM

Senator SANFORD. Let me ask you another question. I understand the trouble that banks are having and I am sympathetic toward broadening the powers, but why do you find it impossible to compete with GE and GM?

Mr. WRISTON. Well, there's no way that we can borrow money at 3.9 percent for openers, and there is no way we——

Senator SANFORD. Why can they borrow at 3.9 percent and you can't?

Mr. WRISTON. Well, because they make it in the price of the automobile and we don't have any automobiles for sale. So if they make 30 percent on their automobile, they can give away the money and that's the kind of competition we're up against.

Senator SANFORD. Does all of their capital comes from sales?

Mr. WRISTON. I beg your pardon, sir?

Senator SANFORD. Don't they go into the market and borrow money or does all of their money come from profits?

Mr. WRISTON. Well, they go in the market and they borrow money but they can't borrow it at that amount. The United States of America can't sell a Treasury bill at that rate.

Senator SANFORD. So is it your source of borrowing money that puts you at a disadvantage?

Mr. WRISTON. It's a source of having a product to sell on which you make a profit that you can offset against your loss on your loan.

Senator SANFORD. But doesn't American Express have that same advantage?

Mr. WRISTON. No, sir.

Senator SANFORD. They sell many products.

Mr. WRISTON. They don't sell any manufactured goods that I'm aware of. Sears has that and Penney's has that.

Senator SANFORD. But does Sears use its profits from the sale of manufactured goods to provide capital for its banking operation?

Mr. WRISTON. Well, let's say there is no charge for their credit card and they have the largest number of credit cards outstanding and there's no way you can make money unless you do charge.

Senator SANFORD. Well, I thought you approved of the kind of structure that American Express has.

Mr. WRISTON. I do.

Senator SANFORD. But you don't approve of Sears' structure?

Mr. WRISTON. No, I have no problem with any competition. I believe it's a tough, competitive world, and all I have ever testified for 25 years in this room is give us the chance to compete. I may be wrong but I've been consistent. [Laughter.]

Senator SANFORD. What could we do that would allow you to compete with cheap money in a similar manner as GE and GM?

Mr. WRISTON. You can't do anything to compete with that. What you can do is to permit us to have subsidiaries of holding companies, like American Express, let us go in the insurance business, which is nothing more—the insurance business now owns Dillon Read, as you know, and Bache, and so there is——

Senator SANFORD. Let me follow up that question with Mr. Weinberg. I continue to be impressed with the statistics that 5 firms control 72 percent of the domestic market. Despite significant barriers of entry into commercial paper, only a handful of firms control virtually all of the industry. Similar circumstances exist among investment firms.

Why would it not be better to spread that out and diversify it?

Mr. WEINBERG. Well, competition is in the process of trying to do that every day, but I'd like to deal with the commercial paper business. Our firm was started in 1869 solely for the purpose of the commercial paper business and we've been in that business ever since. I think that the confusion here is about what is dealer paper. General Electric, General Motors, Ford, large units, and many other companies sell their own paper, that's what we call direct placed paper; and dealer paper is paper that Goldman, Sachs and all the other investment firms sell—they are dealers who buy it from a company and resell it. There's a big difference and there are far more than—I haven't seen the statistics recently, but our share of the dealer market in recent years has been going down to no more, than 20 or 25 percent I think, and it may be even lower, because everybody is in it now. And the point is, there is not that concentration that there used to be. Today it's different than it was.

Senator SANFORD. Thank you. My time has expired.

Senator GARN. It's a tough business when you drop all the way to 20 or 25 percent of the whole commercial paper market. [Laughter.]

Mr. WEINBERG. Well, you know, when you come right down to commercial paper, it has become a commodity business where you don't make money. We've been in it all our lives so we still continue it. You can check and we can give you the figures, but it is a business that you do as a door opener or you do it as part of a service business. That's what it really is. But everybody's in it. The banks are in it.

[The following was subsequently submitted for the record:]

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Tel: 212-902-8555

John L. Weinberg
Senior Partner

Goldman
Sachs

July 1, 1987

The Honorable William Proxmire
Chairman
Senate Committee on Banking, Housing and Urban Affairs
534 Dirksen Senate Office Building
Washington, DC 20010

Dear Mr. Chairman:

As I stated in my appearance before the Senate Committee on Banking, Housing and Urban Affairs on June 18, 1987, I had not recently seen statistics on the market share of Goldman, Sachs & Co. and other firms in the commercial paper market. Since that time, I have gathered 1986 data relating to the commercial paper market and have enclosed this for your information.

You should be aware that the enclosed statistics are not published anywhere and are merely Goldman Sachs' best estimates gathered from a variety of sources. None of the figures include commercial paper issued directly by the dealer for itself. For example, in 1986 Merrill Lynch issued approximately $8 billion for commercial paper for its own use. Each commercial paper dealer most likely has a different market share breakdown.

Moreover, it is important to note that the commercial paper market is comprised of two components -- dealer-placed and direct. The direct segment of the market, principally the larger finance companies and U.S. bank holding companies, accounted for 46.1 percent of the $332 billion of commercial paper outstanding at year-end 1986. Direct issuers, due to the large size of their commercial paper programs,

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consider it cost-effective to establish and manage their own sales force for marketing their paper directly to investors.

The dealer-placed segment consists of commercial and industrial corporations, utilities, U.S. bank holding companies, finance companies and major non-U.S. banks. Each of these companies maintains a relationship with one or more dealers whose principal role is to market the issuer's paper to institutional investors. These issuers find it cost-effective to sell their notes through a dealer due to the size or seasonality of their commercial paper programs. Goldman Sachs' share of the total commercial paper market in 1986 was approximately 12 percent. For dealer-placed commercial paper, Goldman Sachs' share was 22 percent.

I hope that this information is helpful to you. With kind regards,

Sincerely,

John L. Weinberg
Senior Partner

New York Boston Chicago Dallas Detroit Houston Los Angeles Memphis Miami Philadelphia St. Louis San Francisco London Tokyo Zurich

1986 MARKET SHARE OF COMMERCIAL PAPER DEALERS
(BY DOLLAR VALUE OF PROGRAM, DOES NOT INCLUDE DIRECT CP)

Dealer	Total Market Share(%)	Dealer-Placed Market Share (%)
Goldman Sachs	12%	22%
Merrill Lynch (1)	12	22
Shearson Lehman	9	17
Salomon Brothers	8	15
First Boston	8	14
Others	5	10

Size of 1986 Dealer-Placed CP Market = $180 Billion
Size of 1986 Direct CP Market = $152 Billion
Dealer-Placed CP as a % of Total = 54%

(1) Data for Merrill Lynch includes acquisition of A. G. Becker, which was a major dealer of commercial paper.

The **CHAIRMAN**. Senator Chafee.

Senator **CHAFEE**. Thank you, Mr. Chairman.

I'd like to join in saluting this panel which certainly is an excellent one.

I'd like to ask Mr. Wriston a question. Of the 25 largest banks in the world, only two are now American. Now some might say to that, "So what?" Would you state briefly for the record what it means to our country not to have more banks in that 25 largest group? Does it reflect in jobs in America? Does it affect the sales of our corporations? Why should we care that we're not in that 25?

The second question is, would receiving the 4 additional powers that are traditionally talked about in this committee increase the size of the banks so that they could be a larger section of those 25?

The first question is, what difference does it make?

Mr. **WRISTON**. Well, Senator, I think the difference that it makes is it's a big world that requires big amounts of money and the ability to take big risks. In any given day in the city of New York, Mr. Corrigan will tell you that $1.5 trillion changes hands every day and that the ability to play in that marketplace requires massive institutions that can take that risk.

FOREIGN INSTITUTIONS ENTERING OUR MARKET

And what is happening now is that the foreign institutions are entering our market and they have entirely different structures. The Japanese banks' capital ratios are almost nonexistent. They are different in many countries. So you have a comparative disadvantage with those.

Second, does it impact financing of trade? I don't really think it does. The problem with financing trade in smaller towns is that the banks there do not have the skills which is no denigration of their ability. It's just that they haven't traditionally been using those kinds of skills. They know a lot more about agriculture than we do, but less about export finance. So that I'm not sure that larger institutions could help on that unless they spread out as they are now spreading out across the United States with interstate banking. That brings to the farmer and the manufacturers in various cities across the country the expertise on how to finance American exports. To that extent, it would be useful certainly.

Senator **CHAFEE**. And if the banks received those 4 powers—the mortgage-backed securities, mutual funds, commercial paper and municipal revenue bonds—would that significantly affect the growth of banks in this country.

Mr. **WRISTON**. I think it would affect significantly the growth, but those are still not powers that create a market in which the banks could compete against the Travelers Insurance Co. that owns Dillon Read or against Bache or against General Motors or against others.

What we're looking for is the functional separation. The mutual funds is fine. The mortgage-backed securities—the world is going toward securitization and shrinking balance sheets, but it would help.

Senator **CHAFEE**. I see. Mr. Weinberg, why shouldn't commercial banks issue commercial paper?

Mr. **Weinberg**. Well, they're already doing it now. I think they're in the process of doing it and it's historically been separated and the direct placed people who sell much more—we're talking about our business and we're dealers, but the people like General Motors and Ford, they sell it directly. Banks want to be in the dealer part as a service, which is what it is. I think that that game is really over now as far as getting the banks into it. It's what you all should decide and that's fine with us. We have been fighting this for a long time, but I think now that the loophole has been so wide for so long and they're in it and they're doing it.

Senator **Chafee**. Thank you.

The **Chairman**. Thank you, Senator Chafee. Senator Garn has a brief remark before he has to leave.

Senator **Garn**. Thank you, Mr. Chairman.

I just wanted to thank each of the gentlemen for coming and apologize for having to leave, but what I'm going to is a meeting with nine members of the Japanese Diet who serve on our corresponding committee. I met with them in Japan in April to talk with them about opening up their markets to all U.S. financial firms—banks, insurance companies, securities, across the board. And they are paying a return call, so I'm going down to talk with them on behalf of all of the industries of the United States and say "Open up those markets or we're going to close ours."

Thank you very much, Mr. Chairman.

The **Chairman**. Thank you, Senator Garn. Good luck. [Laughter.] Senator Riegle.

Senator **Riegle**. Thank you, Mr. Chairman.

I think this hearing today is an important step for all of us and I appreciate the testimony that's been given. We've had to work awfully hard just to get to the point where we're able to try to get these issues up on a table in a coherent way and clearly they need to be.

I think the fact that Senator Garn is going to meet with the Japanese right now is in a sense illustrative of the fact that the world has changed and international competition I think is breaking over us in a way that means that we'd better understand these issues and deal with them before more time passes, whatever judgments we reach.

BANKS RIDING ON PROFIT ROLLERCOASTER

Mr. Corrigan, I want to ask you about bank profitability. Some banks in the country seem to be able to do quite well, make a lot of money in terms of return on equity over a period of time. Other banks seem to be riding a different kind of a rollercoaster. Some banks have lost enormous amounts of money.

My basic question is this. Does the data that you have seen—and I know that you've studied this with some care—does the data that you've seen indicate that banks can in fact be profitable in the traditional lines of business as they exist today, or is it just absolutely impossible for banks to be able to operate within, if you will, sort of the traditional lines and do it profitably and consistently?

Mr. **Corrigan**. Again, if you look at banking as a whole, the fact of the matter is that the numbers on profitability really aren't all that bad. Banking as a whole is somewhere in the middle of a spectrum of industries in terms of returns.

If you look at the very large banks, the situation is not as good, in part because of some of the reasons that Mr. Wriston mentioned before, and in part because right now the industry, including the big banks, has a lot of asset quality problems that are depressing earnings.

However, when you look through it all, the conclusion I draw is that the profitability of traditional deposit intermediation-type activity is I think subject to some question, especially as securitization and some of these other things take hold.

Indeed, one thing that worries me—and this applies I think to the securities business as well as to the banking business—is that when you look at the sources of returns of these institutions, more and more of the income is coming from trading-type activities. Indeed, I sometimes ask myself the question, how is it possible that every major company earns a whole bunch of money every quarter from trading foreign exchange? Who's the loser? But that dependence on those sources of income I think is problematic. Indeed, it may even be telling us that we are developing a kind of a vested interest in volatility.

Senator RIEGLE. Let me ask you there, is that the whole picture? I want to get to foreign loans and I want to pose a question to Mr. Wriston as well.

But what I'm concerned about here, are there examples—and you would know perhaps better than anybody because you've really zeroed in on this—are there examples of major banks in the country that have managed to remain quite profitable with return on equity?

Mr. CORRIGAN. Yes.

Senator RIEGLE. Why is that? Why have some managed to do it and not others? I would pose the question against foreign lending. I've got a chart in front of me that shows set asides for losses on foreign loans, particularly and obviously it's very much in the news because everybody is taking big write-downs right now and presumably have a lot more to do. You talk about bad assets and that's just part of the story, but that's a very visible part of the story.

Have the banks that have done well, have they tended to avoid foreign loans? Why have they done well and why have some not done well?

Mr. CORRIGAN. Well, again, I think the answer is a very simple one. I think it basically comes down to management.

Senator RIEGLE. To management?

Mr. CORRIGAN. I think so.

Senator RIEGLE. But if that's the problem, we're not going to solve the management problem here.

Mr. CORRIGAN. Well, again, you asked the relative question, why have some banks done better than others, and I think that is fundamentally the answer there. But I repeat, that as I see it, there is indeed a question as to the underlying profitability associated especially with the traditional, plain vanilla, intermediation-type activities.

PROBLEMS WITH FOREIGN LENDING

Senator **Riegle**. Mr. Wriston, let me ask you this because you're an expert on bank profitability or certainly concerned about an erosion of it which Mr. Corrigan sees. Address if you would the issue of foreign lending. It seems to me the big banks have gotten into this in a big way that hasn't worked out very well. We're seeing the results of that now.

I have a question in my own mind as to whether our Government should be, in effect, taking on some of those foreign loans rather than the private banking system, but if you were to take that part of the problem away, that doesn't solve all your problems, but hasn't that been an enormous problem for you and isn't it today? I mean, nothing has been said about it and it seems to me you ought to comment on it.

Mr. **Wriston**. I'll be glad to. Five years ago I testified here and said no American bank would fail because of foreign loans but a lot would because of American real estate and oil patch. That turns out to be true.

On the foreign loan situation, the perception of the marketplace was that every time somebody south of the border said something the stock of the major banks declined and so what happened was—and properly so, in my view—they transferred from undivided profit to loan loss reserve, which is not the same as a write-off, as you know, and they probably will not be written off. To my knowledge, all of those loans, with the exception of Brazil, are currently being serviced.

So what happened was a bookkeeping entry which the market applauded and stocks of those institutions have risen very sharply.

You're never going to solve the problem in a day or a week because we had the worst recession since the 1930's. The Fed locked the wheels of the world. Nobody knew that was going to happen and we've had no growth basically around the world. When growth picks up, I think you will find that those things will work out over time.

Second, the banks that have been profitable have been basically going into the investment banking business and they have abandoned the consumer. They have abandoned serving the small people and the branch systems and their returns more closely mirror those of investment banking. And that's fine. I applaud them for it.

Those banks that are truly financial service businesses who have gone into the consumer business and the investment banking business and the traditional business are taking hits that build businesses for tomorrow. And one of the criticisms of American industry has been they're short term oriented. On the other hand, if you build a long-term business, it depresses your current earnings.

Senator **Riegle**. My time is up.

The **Chairman**. Thank you, Senator Riegle.

Senator Karnes.

Senator **Karnes**. Thank you, Mr. Chairman.

I also applaud the panel for attending and presenting their remarks and, Mr. Chairman, I do have a statement for the record that I would like to enter.

The CHAIRMAN. Without objection, it will be printed in full at the beginning of the hearing.

Senator KARNES. Mr. Wriston, you commented about the American Express and I would just ask a technical question. At the holding company level at American Express, are there any regulatory bodies that look at the holding company level presently as that entity is structured?

Mr. WRISTON. The SEC, of course, they have to file a 10(k) when they issue stock, so they have complete disclosure through the Securities and Exchange Commission. There is no oversight regulatory body, to my knowledge, other than that.

Senator KARNES. And in your opinion, that is satisfactory?

Mr. WRISTON. It's worked awfully well for them.

Senator KARNES. As you indicated with the holding company itself with the SEC oversight, that is satisfactory?

Mr. WRISTON. It's worked awfully well for them.

Senator KARNES. That's what I surmised. I guess I'm taken with the tremendous growth of the individual depositors' funds flowing to alternative accounts many of which are uninsured accounts.

Is it fair to say that with this increased competition and the institutions solicitation of depositors as we're seeing, including airlines that Senator Armstrong talked about, that the importance of Federal insurance of depository accounts is decreasing and does this concern you, Mr. Corrigan?

Mr. CORRIGAN. Well, consumers should have choices and should be free to exercise choices and if a consumer is attracted by slightly higher returns that they can get in a transaction-type account in a noninsured institution, I guess they should have the right to do that. So in that fundamental sense, I'm not concerned.

I found it interesting, though, that when I was recently discussing this subject with a group of liberal academicians, to my surprise they were much more concerned about that than I was. So maybe it is something that I should think about a little more than I do, but I don't have any great problem with that, no, as long as the outlet of the insured deposit is there.

Senator KARNES. Well, the impetus for much of the statutes that we're dealing with today stems from the problems we had in the late 1920's and 1930's. The safety and soundness of the system is something that I hear frequently being a reason for having regulations in place and prohibiting maybe expansion of banking powers.

But it seems that the consumer is able to make a decision as to what he feels is best suited for his financial investments and that he's moving his funds accordingly, but nonetheless, some people surmise that we are maybe following a course we have followed before which led to some disastrous results, and your comments indicate, I would submit, that the investing public, the depositing public, is making an informed decision as to where they best should put their funds and deposit insurance availability is one consideration but it is not apparently the primary consideration because they're looking for yield.

Mr. CORRIGAN. I don't think you can quite go that far. I mean, the stock of insured deposits, household-type deposits, I think is still a good deal larger than the pure transaction-type vehicles that we see outside of the deposit insurance system.

But again, the only question is, how well informed are those decisions? Do people really understand when they're insured and when they are not? If you go back to the things like the Ohio thrift crisis in 1985, it's not entirely clear that those judgments are always on the basis of the information that we assume is there in the first place.

Senator KARNES. Is that something that you would suggest Congress should become more involved in, providing more disclosure or more information to the consumer about the safety and soundness of these unregulated, uninsured accounts?

Mr. CORRIGAN. I do not think so. Again, there are disclosure requirements right now associated with the operation of most of these types of things through the SEC or otherwise, such as Truth-in-Lending and various other consumer protection arrangements that exist right now that apply to those things in greater or lesser degrees. So I don't think there is an overriding problem there, but it is a matter of some concern, though.

Senator KARNES. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Karnes.

Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman. I would also like to submit for the record an opening statement.

The CHAIRMAN. Without objection, it will be printed in full at the start of the hearing.

Senator GRAHAM. That statement summarized, Mr. Chairman, applauds you for undertaking this architectural approach to the problem that we've been in my brief period here responding to crises and now we're trying to ask what type of a structure we want to build for the next decade and into the 21st century.

Mr. Corrigan, I have also been impressed with your statement of January of this year. I wonder if you can tell us, assuming that we did nothing and let the nonpublic policy forces that are currently at work continue to operate in the next decade as they have in the past, where you think our structure of the financial industry would be; and conversely, if we were to adopt in toto your recommendations, where do you think we'll be as we enter the 21st century.

Mr. CORRIGAN. There's heaven and hell for you right there. [Laughter.]

Senator GRAHAM. I assume you have no further comment beyond that.

Mr. CORRIGAN. I think that's it. I shouldn't be that flip.

Senator GRAHAM. We've already had Plato. If we could have Dante, if you could give us a little further description of what heaven and hell should look like?

FAILURE TO ACT CARRIES SERIOUS DANGERS

Mr. CORRIGAN. That answer was maybe a little too flip, but I would simply like to emphasize that I do see that a failure to act in some broad way carries with it very serious dangers. Some of them haven't been touched on: the further loss of international competitiveness; a further erosion of what I call the impartiality of the credit process itself; and indeed a further erosion and perhaps a major erosion of the overall public safety net apparatus which I still care about. I think that those are dangers which in a context in which more than a few people think there is a question as to the fragility of the system right now, simply involve risks that I don't think are worth taking and I don't think they are in the public interest to take.

The CHAIRMAN. Senator Graham, that's such a good question and I think the answer is so important, would you give us an answer in detail in writing?

Mr. CORRIGAN. I would be happy to do that, Senator.

Senator GRAHAM. In that same writing, if you could describe heaven, what the situation would be like if we were to adopt your plan in toto. A concern that I have in my experience with dealing with economic issues in which there are strong in-place competitive interests and substantial resources at stake, that change tends to occur when the users of the system begin to appreciate the risks of the status quo and therefore become advocates for change and a concern is that I have not at this point seen much of a user interest. And I'm using the word user in the broadest sense of current mayors of cities, governors of States, corporate leaders, small businesses, the homebuilding industry, others that have a major stake in whether we go to heaven or hell in the next 10 years haven't been very vocal or have not appeared to have placed this as a high priority on their own agendas.

Do you have any sense of why they are inactive?

Mr. CORRIGAN. I think the answer here is that in this particular venue people don't seem to care all that much until something goes wrong. Again, I think one of the dangers here is that if inaction exists to the point where there's an accident someplace, then I think what undoubtedly will happen is that we will get reform not of a progressive nature, but we will get reform, if that's the word, of a regressive nature. And I think that's one of the things we should be sensitive to.

But in this area I think it's true that more often than not, unfortunately, it takes something to go wrong.

Senator GRAHAM. I wonder if Mr. Wriston and Mr. Weinberg could comment as to what you think the state of financial services will be 10 years from now if we abdicate a public policy role and continue to rely on nonpolitical factors to shape the industry.

Mr. WRISTON. Well, Senator, I'm not sure that we'll be in Dante's world if we do that. The reason for that is that, as I mentioned, the noninsured deposits savings of the country of $2 trillion are now approaching the total assets of the commercial banks, so that half of all the savings in this country are not in our system. And if we fail to act in this Congress, what will happen, in my view, is that the major corporations—the General Motors and the GE's—will continue to enter the financial service business, they will continue to supply excellent service to the users, to the customers, and as I said, if you're a customer, you really don't care who owns the lender. You want the money and if you get a good mortgage or a good car loan or a good commercial loan, the fact that it's in Fairfield, CT in General Electric or in Detroit or in your friendly local banker, I don't think the user cares.

So in the absence of this distinguished body acting, what will happen is the banking sector will continue to shrink and the nonbanking sector will continue to grow and supply the services to the consumer. That's my guess.

Mr. WEINBERG. Well, I know your time is up but I would just say this. I think that one of the reasons why financial services have been so popular and why everybody is trying to get into them is because we have had over the last number of years good business conditions, low inflation and interest rates that are going down.

When and if that turns, which certainly it will occur as sure as God makes little green apples, I believe that that will change people's thoughts about how attractive the financial services business is. This is a cyclical business, not just investment banking, the whole financial services industry. The business cycle exists, it will impact very, very strongly the banking institutions and investment banking institutions—you can read in the paper every day and see how it already is.

The economy in effect will impact a lot of what you're asking.

The CHAIRMAN. Thank you, Senator Graham.

Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

First of all, I want to echo the comments of others in thanking the panel.

Mr. Corrigan, I particularly want to thank you for trying to develop a fresh analytical approach in looking at these problems. I mean, without even addressing the substance of your conclusions—and those are very interesting and worthy of considerable thought, but at least you have come at it with a framework of analysis that relates it to the public interest, which is what I think the responsibility of this committee and of the Congress is. And it's our job to seek the structure of the financial system that serves the public interest.

Now whether that means that particular elements in the private sector will be restrained or unleashed is a judgment that's going to be made related to the public interest, but not related to their particular private objectives, although you try to harmonize those as best you can.

DEPOSIT INSURANCE

I think I really want to go back to some very basic questions. Does anyone think that we could run a financial system—could or should run a financial system without deposit insurance?

Mr. CORRIGAN. No.

Senator SARBANES. You say no.

Mr. CORRIGAN. No, we should not.

Senator SARBANES. Fine. Mr. Wriston?

Mr. WRISTON. I think that deposit insurance has become an essential part of the system. I think where it's gone wrong is that it has been extended to people who shouldn't have it. It was designed to protect those who cannot protect themselves, and properly so, and we have raised the amount that's insured and during the bailout of Continental it was raised to infinity. I believe the deposit insurance should remain in place, but I think it should be clear that there is a limit and that limit should encompass the people who should not take a risk with their savings.

Senator SARBANES. So you think that Continental Illinois was a bad decision?

Mr. WRISTON. Yes, sir.

Senator SARBANES. All right. Let's strip that away. Then the next question is, do you think being at $100,000 is a bad decision?

Mr. WRISTON. I think at this point in the world with the inflation that we have not enjoyed over the last 25 years, that $100,000 is a good ceiling.

Senator SARBANES. Mr. Weinberg.

Mr. WEINBERG. Oh, I think you need the deposit insurance. I'm not an expert in this.

Senator SARBANES. Let me ask my next question then.

Does anyone think that you could have or should have a financial system in which you require 100 percent reserve banking?

Mr. CORRIGAN. I don't know, the way you worded it, whether I want to say yes or no. Do we think that's desirable? My answer is no.

Senator SARBANES. Do you think you could have? You would have a system that would have inadequate credit, would you not, under modern economic circumstances?

Mr. CORRIGAN. I just don't think it's workable. It's neither desirable or workable.

Senator SARBANES. Now does the institution that has the deposit insurance and is able to extend credit on partial reserves thereby come under any special responsibilities or obligations?

Mr. CORRIGAN. I believe that indeed it does. I think that there is, in essence, a social compact involved here, that if you get from the public sector and from the Congress and the Government certain privileges, including deposit insurance, access to the lender of last resort, et cetera, there's a quid pro quo, and the quid pro quo is that you accept a certain degree of supervision and you accept the responsibility to conduct your affairs in an impartial and straightforward way.

Senator SARBANES. Do you agree with that, Mr. Wriston?

Mr. WRISTON. Yes, sir, I do.

Senator SARBANES. Mr. Weinberg?

Mr. WEINBERG. Yes.

Senator SARBANES. Now if that institution is going to extend its activities beyond the normal range, under what conditions should it do that?

Mr. CORRIGAN. Well, my answer to that is that, first of all, as I've said, I would not permit an unlimited expansion. I would restrict it to things that are financial in nature.

But second, I would take the point of view that the ability to do those expansions would have to be tied to maintaining a basic financial soundness in the firm—adequacy of capital being primary among those things. I do think that there has to be that kind of apparatus in place, in part because government funds are at stake.

Senator SARBANES. Well, Mr. Chairman, my time is up. I was just beginning to get into this. Let me just make a couple of comments about the testimony.

Mr. Wriston, I think your observation that the consumer will go where the interest is the best and doesn't really care is correct, but it raises a serious problem that Mr. Corrigan addresses in this financial market structure statement and that is the unbundling of the credit system is what it amounts to. As I understand his argument, you have to look at it as a whole and if you start unbundling it, then the credit system itself begins to unbundle.

And one of our responsibilities may be to figure out some way to try to hold the credit decision-making process together in a sensible way. Otherwise, each part of it will be picked out for particular reasons but the overall system will not make sense.

I may stay around and come back for a second round if we're going to have it.

The CHAIRMAN. Senator Sasser.

Senator SASSER. Thank you, Mr. Chairman. I have an opening statement, Mr. Chairman, that I would request be included in the record.

The CHAIRMAN. It will be printed in full.

Senator SASSER. I also want to express my appreciation to the panel for appearing here this morning for what's now a lengthy period of time.

Mr. Corrigan, I have a clarification question that I would like to ask you. Unfortunately, I missed your opening statement, but when you speak in your statement about your proposal for keeping separate banking and commerce, what you actually mean, as I understand it, is keeping separate financial services and commerce. In other words, you're calling for a combination of banks, S&L's, insurance companies, securities firms, et cetera. You have no objection to that, but you don't want to see a combination of, say, Goldman Sachs and General Motors, for example.

Mr. CORRIGAN. Well, actually, as long as Goldman Sachs itself doesn't have an insured depository and those other things that Senator Sarbanes was talking about, I wouldn't have a problem with that.

Senator SASSER. What I meant to say was you don't see a combination of General Motors and Citicorp?

Mr. CORRIGAN. That's it precisely.

Senator SASSER. Now, in other words, you have no problem with Goldman Sachs owning a bank, is that correct?

Mr. CORRIGAN. No, as long as they are not owned by General Motors.

Senator SASSER. Right. In other words, it's all right to have a combination of those who are in the financial services industry owning banks?

Mr. CORRIGAN. Exactly.

WALL BETWEEN FINANCIAL SERVICE INDUSTRIES ERODED

Senator SASSER. Now my question to you is this. In an ideal world, would you prefer this situation or are you simply accepting this as a fait accompli, that as a matter of fact, the wall between the various financial services industries is now down, it's eroded, it's a matter of fact, and we might as well just make the best of the situation as we can at this juncture?

Mr. CORRIGAN. There might be a little of that in my thinking. It's certainly a fait accompli. Now if one could roll back time—but one can't. It's an academic, wholly hypothetical question, but I am quite comfortable with the kind of thing that I have suggested so long as, in the process of doing that, we take care of those public interest, safety and soundness considerations along the way.

Senator **Sasser**. Well, how concerned are you about the argument that's advanced by those who would oppose such consolidation that this monolithic—as they perceive it—concentration of economic forces is a dangerous prospect for the financial services industry and for the economy as a whole? How much of a problem does that pose for you?

Mr. **Corrigan**. Well, that could be. I mean, there was some commentary earlier in the hearing about megabanks. I don't think megabanks are a very good idea. I don't have any problem with very, very large banks, but the idea of a half a dozen or so financial institutions I think is quite problematic to me. So I do think that as part of the agenda of public policy considerations that have to be attended to, one aspect clearly is safeguards against excessive concentration.

Senator **Sasser**. Well, what would those safeguards be?

Mr. **Corrigan**. Well, it could take any number of forms. We've got a lot of them there right now in the antitrust laws themselves and, indeed, any transaction involving, say, the acquisition of a bank or a bank acquiring another financial company through its holding company is subject to review right now on antitrust grounds. That apparatus I think has served us very well indeed.

From time to time, I believe Chairman Proxmire and others have suggested one or two different approaches that would have some quantitative guidelines in terms of percentage of markets and things like that. I'm a bit agnostic about that. But I think it is not all that difficult to have a set of arrangements that would satisfy us that that concern about concentration has not been swept away under the rug.

Senator **Sasser**. Well, my time is up, but one final, quick question. I notice that one element of your proposal is to provide for the payment of interest on the reserves that are required of the banks.

How much does the failure to pay interest cost the banking industry today? Do you have any idea on that?

Mr. **Corrigan**. Well, let's see. There is something on the order of magnitude of $40 billion of reserves. At a current interest rate of 7 percent, that's $2.8 billion in that direct sense.

Senator **Sasser**. Would it cost the Treasury that much?

Mr. **Corrigan**. Well, the totality of it would not, Senator, because——

Senator **Sasser**. We're out of cash around here.

Mr. **Corrigan**. I'm suggesting, among other things, that you also pay interest on demand deposits, which would generate some offsetting tax revenues. There would be a net cost to the Treasury, but not of that order of magnitude.

Senator **Sasser**. Thank you, Mr. Corrigan. And I want to again thank the other two witnesses, Mr. Chairman, for appearing here this morning.

The **Chairman**. Thank you, Senator Sasser.

Senator Dodd.

Senator **Dodd**. Thank you, Mr. Chairman. I apologize to our witnesses and the committee for being late in arriving here this morning and I've been told that a couple of these questions have not been asked, but if they have been, please just say so and I'll pick up your responses from others if I can.

Mr. Wriston, the assumption I suppose that one might draw, based on having looked at your testimony, if the question were asked, why is it today that we have so few financial institutions that are ranked in the top ten internationally, is that we haven't deregulated.

I wonder if you would expand that answer at all, if there are other factors in your mind that have contributed to that beyond the deregulation issue and, if so, what are those other factors that have contributed to that result?

Second, is it necessarily a bad result that we're not big or we don't have institutions that are big in the sense of international financial institutions?

REGULATIONS PROHIBIT BANKS FROM GROWING LARGE

Mr. WRISTON. I think that part of the reason that we have not grown that way is that the regulation has prohibited banks from doing that. And as I mentioned before you came in, Senator, half the total savings in the United States are outside the banking system. I think one of the problems in addressing this issue—we act as if the banks were big and had a big market share. The biggest bank in the country has got 3 percent. The A&P has got more than that, but I don't know another industry that's that fractionated.

And while we have relatively stood still, the General Electric Credit and the General Motors and the Sears and the Penneys have built a system that the consumer likes and the consumer doesn't care where they borrow from. So that by restraining the banks, what we have done is create competitors in our own country and the foreign competitors—we have I guess over 100 foreign banks in the United States now, Jerry——

Mr. CORRIGAN. Over 300.

Mr. WRISTON. Over 300, and they come in and they play by different sets of rules. So that all I'm suggesting is that we should devise a plan by which the American banks can compete within the province of safety and soundness with our industrial competitors.

Jerry made the point that Goldman, Sachs could own a bank. That's fine with me. But Kidder Peabody couldn't. The only difference is the Japanese have got a lot of money in Goldman Sachs but General Electric owns Kidder Peabody and it seems to me to be a distinction without a difference and I'm perfectly happy to have an investment bank owned——

Senator DODD. But the issue of largeness—there's a preoccupation it seems to me with that question and I wonder what your response would be to that. Largeness itself is almost a Soviet notion. If it's large, it's good.

Mr. WRISTON. Before you came in, Senator, I said it was a big world out there and financing one airplane is now $50 million. When I came in the business it was $125,000. It's a big world if you have to finance all of these enormous capital investments around the world and you can't do that with a bank of $5 million assets.

Senator DODD. Mr. Corrigan, Mr. Wriston just raised the point that had apparently been raised earlier in comments and response to questions about the apparent inequity of a Kidder Peabody and a Goldman, Sachs. How fair is it and do you think our banks can compete effectively against a foreign bank that is associated with a commercial enterprise?

Mr. CORRIGAN. Again, one of the principal reasons why I have made the proposals that I have made is because I do think that there are opportunities for greater profits, greater efficiency and greater service out of the kinds of combinations of activities that we are talking about.

As far as the question of what's fair, I would point out that if you sit down and have a conversation with Jack Welch, chairman of General Electric, he would make a very powerful argument that the unfairness is not him, it's the banks, and that he's at a significant competitive disadvantage because the banks have deposit insurance and so on. So it's not all one-sided.

Senator DODD. My time is up. I'll come back.

The CHAIRMAN. Thank you, Senator Dodd.

We'll go on a second round now. I think everybody has had an opportunity to ask questions once.

I have just one question I'd like to ask you gentlemen. I think Mr. Wriston triggered the truth-telling, reality versus the shadows, and I want to follow up on that.

CAMPAIGN FINANCE REFORM LEGISLATION

I know that you gentlemen are not experts on campaign finance reform legislation, but believe me, it relates to the subject of this hearing and I need to question you about it.

It's been argued that a major reason we don't have agreement on a broader financial services holding company framework is because congressional campaigns are enormously expensive, making Members dependent on huge campaign contributions from competing interest groups.

Dependency, it's claimed, results in a legislative gridlock and obstructs a reasoned consideration of the issues each of you are raising this morning.

If the campaign finance situation could be corrected, the gridlock might be relieved and our banking laws modernized.

Mr. Corrigan, do you agree with that assessment and the need for campaign reform legislation? Do you think it's relevant? [Laughter.]

Mr. CORRIGAN. Talk about a fish out of water—I don't feel qualified to answer that question.

The CHAIRMAN. Well, the reason I asked that is I know—you're a sophisticated financier and you know these campaign contributions are made. You know their effect on the people who vote up here.

Mr. CORRIGAN. I will simply say I read yesterday's American Banker and leave it at that.

The CHAIRMAN. I missed that. Say it again.

Mr. CORRIGAN. I said I will simply say that I read yesterday's American Banker and I'll leave it at that.

The CHAIRMAN. I didn't read yesterday's American Banker. What did it say?

Mr. CORRIGAN. The American Banker has a very long, detailed story about the political contributions of financial institutions and their lobbyists and so on.

The CHAIRMAN. Well, it's a democracy and a free country and part of the freedom is being able to contribute to political campaigns and express your views that way. We're all for that, of course. But the question is, if we can reform that in a way that limits campaign contributions, perhaps it can have a constructive effect on the legislation before us here and get some action in an area where it's very badly needed.

How do you feel about that?

Mr. CORRIGAN. I don't want to be uncooperative or unresponsive, but I really don't know a whole lot about the subject. I will agree that certainly in this particular venue there has been it seems to me, what I described in a part of my statement that I didn't read, a winner-take-all mentality that is reinforced by these considerations. But I really have no——

The CHAIRMAN. As Senator Garn pointed out, we've had thousands of pages of testimony over the years and no action.

Mr. CORRIGAN. I agree. I just don't know whether the reforms you're talking about I don't know enough about them to know whether that would change anything. That's all I'm saying.

The CHAIRMAN. Mr. Wriston, how about you? Do you agree with that assessment of the need for campaign reform legislation?

Mr. WRISTON. I'm in total agreement with Mr. Corrigan on this.

Mr. CORRIGAN. I think we ought to mark the calendar and the time that that happened. [Laughter.]

The CHAIRMAN. You're in total agreement with Mr. Corrigan on campaign finance legislation. You certainly know, don't you, sir, that it has an effect on the ability of Congress to act on this legislation? Doesn't it go to the heart of it?

Mr. WRISTON. What I don't know is what the umbilical cord is between these money power group's constituency and legitimate public interest, and that is, unfortunately, what this distinguished body has to sort out. How much is money and how much is the public interest is really what I'm saying, or whether we have a problem that has to be addressed. I couldn't make the judgment.

The CHAIRMAN. You see, it's hard for us to do it because we're right at the heart of it. We're the ones that take the campaign contributions and it affects our careers, whether we stay here or don't stay here, and it's very delicate. So we need the wisdom of people like you who are smarter than we are.

Well, Mr. Weinberg?

Mr. WEINBERG. Well, I'll say that I believe——

The CHAIRMAN. Or are more objective than we are.

Mr. WEINBERG. We're a part of the process and I think it's our responsibility to be so, so I would say that reform of campaign contributions is a sound thing and should be pursued. Possibly it has over the years gotten out of whack. I would support reform, period.

The CHAIRMAN. Very good. Well, thank you, gentlemen. I appreciate that very much. I have to go to the floor and I'm going to ask Senator Riegle to chair the remainder of the meeting.

Senator Chafee first.

Senator CHAFEE. Thank you, Mr. Chairman.

I have a quick question for Mr. Weinberg. That is this. I am extremely interested in this international competitiveness business. I read that the No. 1 Japanese investment banking firm had greater profits than all the U.S. investment firms put together. That, to me, is—I don't want to say frightening—but disturbing. And we're hearing about the enlarged powers that the banks would like. What about your industry? What enlarged powers would you like so that you could become more competitive? Is there anything that you can ask us for that we at least ought to think about?

Mr. WEINBERG. Well, I brought up earlier, under Jerry Corrigan's program, if we were going to get powers to borrow money at the Fed window, and be in the payment system, but we don't want to become banks. We don't want anybody to come in and save us when we get in trouble. We think that we are entrepreneurial. We have a special role and we should be supported to be able to do that. And we don't want to be like the banks. They should be there and they perform a special role, as we perform a special role.

But we've not had too much trouble competing internationally. We are not as large as banks. We are not as large as Nomura Securities, but we do all right and we don't need anything very special. So I would say that being part of the Fed's payment system would be very important to us in domestic as well as international terms.

Senator CHAFEE. What about changes in regulation? Sometimes regulations were imposed years and years ago and are not pertinent today. Is there any change in regulation that seems to make sense that would make you more competitive in the world that you would recommend to us?

Mr. WEINBERG. I'd like to think about that a little bit more. Nobody has asked me that question before. They're usually thinking about putting things on top of us and I think it's a good question. Frankly, we have been trying to go through where we are, but could I think that over and drop a note to the committee? I'd rather give a responsible answer.

Senator CHAFEE. Fine.

Thank you, Mr. Chairman.

CHINESE WALLS

Senator RIEGLE. Let me ask this question. We have had some problems with Chinese Walls of late and we're looking at that in various businesses. I'm wondering, Mr. Corrigan, if we go ahead and start to link up businesses that in the past have been divided, either for reasons of Glass-Steagall or the commerce/banking separation, are you confident that we're going to be able to build Chinese Walls within these institutions, to use that phrase, where you can really avoid the cross-connection where either federally insured deposits are taken over and used in another area that perhaps is of a higher risk and shouldn't be or that the credit function gets used and abused where somebody gets leaned on to buy an ancillary service offered by a financial company that's a bank that maybe doesn't want to buy there but feels obligated to do it because they're under pressure on the loan side?

Can we build these Chinese Walls, in your view? And then I'd like to ask the other two as well.

Mr. CORRIGAN. I think the question is——

Senator RIEGLE. So that they work?

Mr. CORRIGAN [continuing]. Can you have failsafe firewalls is the way I like to put it.

Senator RIEGLE. Firewalls then.

Mr. CORRIGAN. My answer is no. One of my expert witnesses in that blue book in that regard is none other than Mr. Wriston, as a matter of fact. I don't think you can have failsafe firewalls. And it's precisely because I don't think that, that I think that you have to have some kind of consolidated supervision over the entity as a whole.

Senator RIEGLE. Mr. Wriston, I take it that you think that the firewall or the Chinese Wall can be constructed.

Mr. WRISTON. Well, I think it's a nice term—firewall or a Chinese Wall, but the facts are and the reality is that the American Express Co. is out there and it's working and it does have insured deposits and it is a primary Government dealer and it does issue credit cards and it is an insurance company and its holding company is not regulated.

The question is, does it work? The answer is, yes, it works. The markets gives it a bigger capitalization than any bank in the country. That's the ultimate test. So that the answer is, it must work; otherwise, they wouldn't own the 49th largest bank in the United States. Has anyone ever criticized them?

Senator RIEGLE. Well, Senator Sarbanes wants to make a comment.

Senator SARBANES. Well, they may be taking risks on which a payment will come some day and at that point we'll look back and say, well, it didn't work. I mean, before all of these problems happened and at the time that this legislation was put on the books people were saying, well, it's working, people are going there and that's where they're putting in their money and these institutions were growing and, bang. So that doesn't address the question. I mean, these assertions that are being thrown around here—Mr. Weinberg was told that the largest Japanese investment banking company is making bigger profits than all of our business together. Isn't that a terrible thing? I don't know that that's a terrible thing. It may be a good thing. Our companies—I mean, they are making the profit out of someone and our companies may be providing the service at a lower rate in a more competitive environment. That may reflect monopoly profits for all I know.

I don't think the fact that American Express may be working in this context answers the question of whether it ought to be regulated at the top when part of its strength is being drawn from insured deposits.

Mr. WRISTON. Could I respond, sir? You have the same thing with J.C. Penney——

Senator SARBANES. Well, that's a problem, too.

Mr. **Wriston**. And you have the same thing with Sears and you have the same thing with National Steel. You have the same thing with General Motors, which is a holding company incidentally. So the world has passed by that problem.

The question of will you have a problem down the road, sure, we'll have a problem down the road, but the banks got in trouble in the 1930's because the Federal Reserve System did not supply liquidity and I think that every scholar would sustain that statement. That's not an assertion. As a matter of fact, in the President's Economic Report 2 years ago to the Congress, they reiterated that position and I think Jerry would agree with that. There was just that they stopped the liquidity. Isn't that correct?

Mr. **Corrigan**. [Nodding head.]

Senator **Riegle**. The question that I was really posing to you is when you take current situations that are these so-called anomalies, do they have sufficient firewalls, in your view? I gather you are comfortable with what's there and would that be your response for the record?

Mr. **Wriston**. As a consumer.

Senator **Riegle**. Well, I guess I'm not asking as a consumer. We're really asking from the point of view of broad public policy. Maybe your answer is the same, but I am not really asking you from the point of view as a consumer.

Mr. **Wriston**. Well, isn't the consumer the person that at the end of the day determines public policy? Sometimes there are voters in politics, but in business it's the buyer.

Senator **Riegle**. In part they do certainly, but I think there's really not much reason for the hearing here if the whole issue is letting the consumer go where they want to go. We're trying to decide whether the public policy framework that we have needs adjusting and I think there's a general agreement that it does.

The question is, how to do it. And I really think you are sidestepping the question. I say that respectfully. But the question is, are the firewalls that are there now sufficient, in your view, and would you be willing to live with those throughout the whole new system and would they be adequate?

Mr. **Wriston**. Well, all I can do is look at the models that are working and it appears to me that they are working satisfactorily and I'm perfectly comfortable with it.

Senator **Riegle**. So you are then comfortable making the extrapolation that if they're working now for those outfits that have taken those steps that you would be quite comfortable to have the whole structure geared the same way and you would have the same level of comfort?

Mr. **Wriston**. Yes, sir, I would.

Senator **Riegle**. How about you, Mr. Weinberg?

Mr. **Weinberg**. Well, I think this is where we come apart is the fact that, as I mentioned before, when you're dealing with Government guaranteed deposits that the Government has to stand behind, I think it's very hard to have a subsidiary which has Government guaranteed deposits and another part that doesn't, how do you differentiate them and should the Government and taxpayers stand behind these things? I think that requires a different kind of regulation when you're involved in a Government guaranteed situation. I think that's very clear.

ELIMINATE FEDERAL DEPOSIT INSURANCE

Senator **Riegle**. That's part of the dilemma. Let me ask you, Mr. Wriston. Earlier Mr. Corrigan said that maybe we should go to one of two quite different conclusions and maybe one of the conclusions should be that we do away with Federal deposit insurance. What's your thought on that? How important is it to commercial banking or to those entities that now have insured deposits that they continue to have them?

Mr. **Wriston**. Well, I think it's very important. I guess we covered that, sir, when you were out for a few moments. There is no disagreement that we need it. My suggestion was that it should be limited to some reasonable amount which was designed to protect small people. $100,000 in an inflationary world is OK. That's very important.

Just to John's point, there are lots of insured banks that are currently owned by all kinds of industrial corporations, and somehow they work.

Senator **Riegle**. And I did step out when you made that response apparently. I'm wondering, apart from the level—$100,000 or wherever it happens to be—is it your view that you need to have the Federal deposit insurance there as a safeguard or is it there for public confidence or is it there because you think that we're likely to encounter a high rate of failure if we don't have that and the requirements that go with it? What's the rationale for keeping it, if I may ask, because we are now talking about broadening it out in a sense. We're going to put that foundation under basically new financial conglomerates.

Mr. **Wriston**. If my understanding of the FDIC is correct, there isn't a dollar of taxpayers' money in it and there has never been a dollar of taxpayers' money in it. Every dollar that's in FDIC was a tax on the commercial banking business. I believe that's a correct statement.

If the thing were to have a tremendous draw on it, then the public purse would be behind it, but the fact that it's a Government agency doesn't distract from the fact there's no Government money in it. It is all private money, all a tax on the commercial banking business.

Second, I think that it's been baked into the culture of this country to such an extent that even if you could make an economic argument for it to go away, on a public policy basis it should be kept.

Third, I would not keep increasing the ceilings because I think people with substantial sums of money should have some prudence of their own and should be able to take the risks. So I was against paying out 100 percent on deposits in Continental Illinois. I would have paid for the smaller deposits.

Senator **Riegle**. You know, it's interesting. The rationale we were given at that time here unofficially by the Fed was that if they had not gone in and backed all the deposits at the Continental Illinois they expected that the financial system would have collapsed. Now I don't know whether that's accurate or not, but that's what we were given as an official rationale for that kind of step. Of course, that made many of us wonder, if that's true, how fragile is the system if one bank can take the whole thing down and where you have to have, in a sense, an override of the laws to keep it standing?

But you obviously didn't share that view and don't today.

Mr. **Wriston**. It has been said here that some people believe the system is fragile and I think I view that about the way Churchill viewed it when Hitler said that he was going to wring their necks like a chicken. He said, "Some neck and some chicken."

What I would say to you is we've had the near bankruptcy of the city of New York, we had the State of New York unable to sell its bonds in the marketplace. We had oil go from $2 to $30 and back down to $12. We had an OPEC embargo. We had the failure of the Herrstatt Bank. We had all of these things and the system is functioning out there every day.

So I believe that the market is a great deal stronger. From a public policy view if you're sitting there, they erred on the side of carefulness and that's what a central bank clearly has to do.

My view was that the market would absorb that. Goldman, Sachs remembers that the Penn Central had $300 million of commercial paper coming due one day, and the Fed was very excited about that and the market took it and the system worked.

Senator **Riegle**. Well, you make a good point. Let's hope it continues to work. We are all here to make sure that it does insofar as we're able to help ensure that.

Senator Sarbanes.

Senator **Sarbanes**. Mr. Wriston, you referred to the banking system as being fractionated. Others I guess would use the term decentralized. I guess my question then would really be to Mr. Corrigan about the question of the concentration of economic power. We've heard the assertions today that we don't have any banks amongst the largest banks in the world. It's not quite clear to me why that's such a disadvantage. Would you address that question?

Mr. **Corrigan**. Well, I do think to some extent the size issue is, if I could put it this way, something of a boogeyman. It is important, but I don't think it's decisive.

In the case of the Japanese banks in particular, it is true, as Mr. Wriston suggests, that they operate with quite favorable, relatively low capital ratios and we're working with the Japanese right now to try to fix that.

JAPANESE SUCCESS REFLECTS ECONOMIC CONDITIONS

But it is also true, without a question, that one of the reasons why the Japanese banks have grown so fast reflects the underlying economic conditions in Japan. Japan has over the last several years been running very, very, very large current account surpluses and those surpluses are all private surpluses and it's inevitable that that, in turn, reflects itself in those private surpluses working themselves back into the system through the banking system.

So it's not all simply a competitive question. There are underlying economic forces that bear on what's happening to banking systems in country one versus country two.

Now having said that, I do, however, agree that there is an issue here and I'd like to see a list of the 10 best banks made up of American banks, not necessarily the 10 biggest banks. Again, I don't think it's size per se. But, as Mr. Wriston suggests, size is not unimportant in terms of customer service, in terms of risk diversification. I don't have any trouble, for example, with generalized interstate banks in the United States. I haven't had trouble with that for years.

Senator SARBANES. I don't think size is altogether irrelevant, but I just wanted to address this assertion that somehow if we're not in the largest 10 or the largest 20 it's a sign of tremendous deficiency.

In fact, on the diversity of risk question, was it not the largest American banks that overloaded their portfolio in some instances, for instance, with Third World debt?

Mr. CORRIGAN. Again, if I could make the observation, sir, if you look at the composition of assets of the banking systems of all the major industrialized countries and you look at their portfolios of international lending, not all are Latin American—the U.S. banks have more in Latin America and for European banks you have a lot in Eastern Europe and so on—but I don't see that there are huge differences among national banking systems insofar as the exposure of the major banks to international credit risks of one kind or another.

There are differences, but the Japanese banks, the British banks, the German banks, the Swiss banks—they have all been involved with the same types of lending programs.

Senator SARBANES. And it's been the largest of those banks. In other words, the argument that because you're large you will necessarily be better diversifying your risks need not follow. It depends on what risks you take.

Mr. CORRIGAN. Well, obviously that is true. But it is also true that only the large banks—at least up until fairly recently—have been internationally active. That's kind of the essence of a large bank.

But there is no guarantee that the opportunity to provide greater diversity is going to necessarily be used in an optimal way, but it does help, no doubt about that.

Senator SARBANES. Mr. Wriston, what do you think of this point of Mr. Corrigan's in this monograph of his where he says, "There is nothing unique or special about extending credit, nothing unique about making or receiving payments, nothing unique about issuing transaction or demand balances. The difficulty, of course, is that these functions cannot be looked at in isolation." Then he goes on to make the point that, in effect, they have to be unified.

Now in my question I put before—and I really ought to give you a chance to respond to it, your comments in your statement on the consumer doesn't care and he'll go where he gets the rate and he doesn't care where it's coming from is in effect moving us down the path of unbundling the credit process.

How important do you think it is to have the credit process bundled together?

Mr. WRISTON. Sir, I think the reality is the credit process isn't bundled together and it hasn't been bundled together in this country for 25 years. The largest single lender to the consumer for many, many years was Sears. They are not a bank. One of the second largest lenders is J.C. Penney. They own a bank, just the way Sears does, but they are not a bank.

So I think the problem with the analysis is that you keep looking at the banking system which is a smaller and smaller part of the financial system. That's the essence of it.

So all of the GMAC's and the General Electric credit's and the Ford credit's and all of those that own banks—GE doesn't own a bank but most of them do—they have given the consumer a choice. I think that's good. They have given us a lot of competition. But they are totally outside of what you think of or speak here today as a bank.

So credit is unbundled.

Senator **Sarbanes**. Now you don't think they should be regulated, is that correct?

Mr. **Wriston**. Functionally regulated.

Senator **Sarbanes**. And you think the response should be that all of the other financial institutions should be able to move in that direction unregulated?

Mr. **Wriston**. I think, as I testified, that there should be functional regulation. I think the SEC should regulate the securities part; the insurance commissions the insurance part. I used the American Express as a model and that works very well.

Senator **Sarbanes**. Who is going to regulate the overall holding company to ensure that you address the problems of conflicts, the problems of drawing support off the insured section for the noninsured sections? Who would address that?

Mr. **Wriston**. No one.

Senator **Sarbanes**. Would you leave it unregulated?

Mr. **Wriston**. I would leave it just the way it is. It's been unregulated since American Express started and it's working very well. Why would you bring a layer of regulation in? The SEC gets the 10(k) from them. They have to sell their paper in the marketplace and the market likes their paper. As I testified before, they like it better than any bank in America.

Senator **Sarbanes**. Well, of course, the consumers flocked into the savings and loans that were paying these very high rates. The consumers like that and they were throwing all of their money into it and then we paid the price for it.

Mr. **Wriston**. No question about that. They also put half their savings in institutions other than S&L's which are outside the banking system.

Senator **Sarbanes**. I thank you, gentlemen.

Senator **Dodd**. If I can just ask a couple of additional questions, going back to the international issues, obviously I think one of the major factors in why we've got to examine the broader powers of banks is the international competition issue. I don't think anyone can avoid that.

The concern I have—I think it was Walter Heller who talked about a competition in laxity or the lowest common denominator approach and let me address this to all three. Mr. Weinberg, I think it affects the securities industry as well, aside from the issue of expanded powers.

Obviously, today, with markets all over the globe people can pick up a phone any hour of the day and do business. We've all been there. I've actually been to dinner with people who literally have at 1 o'clock in the morning decided to make a purchase of something and can call a market in Europe or in the Far East someplace and do business. So obviously there are these markets attracting capital wherever which offer tremendous and will continue to offer tremendous competition.

The question of how our competitors internationally are conducting their banking business, the concern I think underlies—I don't want to speak for my colleagues at all, but in a sense what I get a feel for is this competition in laxity, and maybe use those words rather than lowest common denominator. But pushing toward that direction.

I wonder if all three of you, beginning with you, Mr. Wriston, might comment on that concern of the competition in laxity, No. 1.

No. 2, should we be—that is, not necessarily the Congress, but the Government of the United States be more of an activist in pursuing some international set of standards as an alternative to the possibility of just trying to drive our own markets in a direction that will compete with other countries that have a variety of different reasons why they have a laxity in standards, be it monopolies or be it just a different culture, totally different economic conditions that allow them to survive and succeed under standards that we couldn't possibly in this country. I wonder if all three of you could just comment on that. As I said, it affects the securities industry, too.

Mr. WEINBERG. I think there's no question. One of the things I mentioned in my testimony was that there is very definitely a recognition in all economies in all countries of the tradition and history of how they evolved. The Germans have their system. The British certainly have made a revolutionary change in theirs but they haven't changed completely. There are still elements of their history and tradition there. And it benefits the way they do their securities business. The French certainly. The Japanese certainly. And even in the United States certainly.

I think that we have—and this is always going to take place—countries are going to try to make it advantageous for their own markets.

FOREIGN INSTITUTIONS OBJECT TO ACCOUNTING STANDARDS

One of the things that I think is a very serious problem for us is that we have the SEC throughout our history, and what they've done in terms of full disclosure has helped make our capital marketplace as good as it is. But a lot of countries don't like our accounting standards and all of the disclosures and the prospectuses and things like that and, therefore, if companies have a choice to finance, they will finance someplace around the world which is not subject to the same regulations that we have. But we see that we're losing business anyway. This country is losing business.

And when we see what the British did to preserve their marketplace in London you recognize how terribly critical it is for them to do that and they sacrificed tremendous things to do it—disadvantaged a lot of their organizations, but we have an outstanding capital market in the United States and we have to be very careful, as Senator Riegle was saying earlier. As you revise these things in terms of current problems in the securities industry, you could very well throw out the baby with the bath water and get yourself in a situation where you would be less and less competitive worldwide. So I see that as a very serious problem.

Senator DODD. Well, should we be moving to some standards? In response to Senator Chafee's question, you said nobody had ever asked you whether or not you wanted to have certain regulatory practices or standards that were bothersome to you, but——

Mr. WEINBERG. I will respond to that.

Senator DODD. But I can envision you being before this committee at some point in the not too distant future saying to this committee,

> Look, they're killing us in London. They're killing us in Singapore. They're killing us worldwide. You guys up here are supporting standards and regulations that make it impossible for the securities industry in this country to compete internationally effectively.

And so what do we do? Are we involved in a competition in laxity? Do we then, in order to compete with that standard, completely drop ours or do we move to try to establish more aggressively through our executive branch or our trade offices or the like some international standards on this so that we don't end up in this competition in laxity?

Mr. WEINBERG. Well, so far, we have not been able to do this. There's no question that our position in the global capital market has eroded because we would not change our standards. I believe the SEC has made an honest effort to be responsive. Maybe they have to make more of an effort, but I will respond to this in writing.

Senator DODD. Mr. Wriston?

Mr. WRISTON. Well, I think the competition in laxity puts a slant on it which I'm not sure that I could agree with. Every country has its traditions. In Germany, the banks are essentially closed end mutual funds. They own the industry there. It works very well for Germany. It might not work at all here.

In Italy, they don't own any industry. It works very well for Italy.

So they drive on the left in Britain, and they drive on right in the United States and they use the metric system in Europe and we use inches here. So that it's kind of a dream to have international law and people have been talking about it for years.

Senator DODD. But standards—they don't say in Britain drive on either side of the road.

Mr. WRISTON. No, but they're not about to change it to the right, though.

Senator DODD. I'm not saying they ought to be the same standards, but some minimum standards.

Mr. WRISTON. Well, I think that the Federal Reserve and the Treasury have been moving to try and get some coordination in international markets and where the Fed comes from is a regulatory viewpoint—more regulations are probably better—and where some of the other countries are coming from is less regulation is better.

But I would argue that with the tying together of these markets with an electronic infrastructure, we have one market. It's what I call the information standard, because information moves instantly into these markets. And if some standards, as you put it, are violated, the market will react. But at the same time, the information standard will drive the central banks of the world to have more coordination and I think that that's good. We come from a different bias in this country than some of the other markets, and I think what we'll wind up as, like all political decisions, some kind of compromise.

Senator DODD. Is it your sense—and maybe I should know this—I don't have the sense that we have pursued that through USTR or others. Do you get a sense that we have pursued coordination at all?

Mr. WRISTON. Well, you take the question of capital ratios. In this country they keep raising them and the idea is that that helps the system. In other countries they have very different capital ratios. I think the central banks of the world, particularly the Bank of England, has got a handshake or a wink or some agreement with the Fed that they will move toward a standard.

The Japanese I don't know about. Jerry would know about it. But I think the world is moving toward that.

Senator DODD. Mr. Corrigan.

Mr. CORRIGAN. Well, I think that in fact there's a lot more taking place here than has been suggested. There has been underway for some time a very conscious effort to move toward a system of convergence in capital adequacy standards for international banks in all the major countries and, in fact, early this year, the United States and the U.K. reached agreement not just on a general framework but in fact on a very detailed overall fully common approach between the two countries.

And we are now very hard at work with the Japanese and others to see what we can do to broaden the group of nations that would be a party to that process. And I think that that, Senator—which is not without flaws, of course. I don't want to suggest that it's perfect. But I think it constitutes a major breakthrough in international cooperation that at its core is sensitive to the very point you have raised about least common denominators.

Senator DODD. Last, because you've all been here so long and been patient, but, Mr. Wriston, I can't resist. There was a comment before I came in apparently that was shocking to me, that General Motors is about to become the single largest holder of home mortgages.

Mr. WRISTON. Originators. So their annual report states.

Senator DODD. How is it that Citicorp is not?

Mr. WRISTON. We are, unfortunately, No 2. We're like Avis. We're still trying.

Senator DODD. What is GM doing? I could understand if this were cars, but how is it that an automobile company is in that position and a bank is not?

Mr. Wriston. Well, they do have one advantage, and that is that they can open a store to originate mortgages in any town in Connecticut, to pick a random example——

Senator Dodd. I'm sorry? Which town?

Mr. Wriston. Or Kansas City, and Citicorp can't. We were not permitted interstate banking and General Motors Acceptance had a store on every corner. When you have local presence, the origination of mortgages is basically a local deal through brokers.

Now with the liberalization of the States and Citicorp has a thousand branches across the country, we're playing catch-up ball, and it's very close whether we're first or second. But the idea that an automobile company's finance sticks to automobiles is just no longer true.

General Electric, as I said, had in their annual report they are one of the 10 largest lenders to American business.

Senator Dodd. Well, all three of you have been extremely patient and I apologize for all this coming and going, but as you all well know, there are 10 other issues going on simultaneously. I'm the chairman right now. Is there anything anyone would like to do while we're here? [Laughter.]

I thank you all and I apologize for the late hour.

This full committee will stand adjourned.

[Whereupon, at 1 p.m., the hearing was adjourned.]

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